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LAW REFORM
INSTITUTE

COST OF CREDIT DISCLOSURE

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ALBERTA LAW REFORM INSTITUTE

The Alberta Law Reform Institute was established on January 1, 1968, by the Government of Alberta, the University of Alberta and the Law Society of Alberta for the purposes, among others, of conducting legal research and recommending reforms in the law. Funding of the Institute's operations is provided by the Government of Alberta, the University of Alberta, and the Alberta Law Foundation.

The Institute's office is located at:

402 Law Centre,
University of Alberta,
Edmonton, Alberta, T6G 2H5.

Phone: (780) 492-5291;
Fax: (780) 492-1790.

The Institute's electronic mail address is:

reform@alri.ualberta.ca.

This and other Institute reports are available to view or download at the ALRI website: http://www.law.ualberta.ca/alri/.

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This final report on cost of credit disclosure legislation has been researched and written by Rick Bowes, one of the Institute's counsel. Mr. Bowes also wrote the other Institute documents referred to in this report. He has guided and managed the project since its inception at ALRI and on its journey through the Uniform Law Conference of Canada ("ULCC"). Mr. Bowes received valuable assistance at various stages of the project from colleagues Janice Henderson-Lypkie, Bill Hurlburt, Peter Lown and Vivian Stevenson, and from a host of student research assistants.

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The 1994 Agreement on Internal Trade between the federal government, the provinces and the territories provides for the harmonization of cost of credit disclosure legislation across Canada. The Agreement created a body called the Consumer Measures Committee and gave the Committee the task, amongst others, of agreeing on the details of harmonized cost of credit disclosure legislation. The Committee set up a Working Group on cost of credit disclosure. In the period from 1994 to 1998 our work on cost of credit disclosure was intertwined with that of the Working Group. The Working Group's many meetings and telephone conference calls were very effectively co-chaired by Rob Harper (Ontario) and Pierre Pitre (Canada).

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CITATIONS AND ABBREVIATIONS

FREQUENTLY CITED STATUTES

The full citation for most statutes and regulations referenced in this report is given in the relevant footnotes. However, the full citation for the following statutes and regulation, which are referred to frequently in the report, is not given in footnotes.

Consumer Credit Transactions Act S.A. 1995 c. C-22.5
Cost of Credit Disclosure Regulation Alta. Reg. 198/99
Fair Trading Act, S.A. 1998 c. F-1.05
Interest Act, R.S.C. 1985 c. I-15
Truth in Lending Act 15 U.S.C. 1601

ABBREVIATIONS

AIT	Agreement on Internal Trade
ALRI	Alberta Law Reform Institute
APR	annual percentage rate
ccdl	cost of credit disclosure legislation (generic)
CCDR	*Cost of Credit Disclosure Regulation*
CCTA	*Consumer Credit Transactions Act* (repealed by FTA)
CMC	Consumer Measures Committee (established by AIT)
FTA	*Fair Trading Act*
TCC	total cost of credit (as a dollar amount)
TILA	*Truth in Lending Act*
ULCC	Uniform Law Conference of Canada

WORKS CITED

The footnotes in this report refer to books, articles, law reform reports and other secondary sources by means of the abbreviated references in the following table. Some of the unpublished ALRI documents referred to in the table may be on the Institute's web site at <http://www.law.ualberta.ca/alri>. If not on the web site, they may be obtained by contacting the Institute.

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A. Introduction and Summary

[1] Unlike most Alberta Law Reform Institute ("ALRI" or "Institute") final reports, this report does not recommend specific changes to a body of law. This report is intended to serve the following purposes:

- to describe the general objectives and contours of a body of law that can be most succinctly described as cost of credit disclosure legislation ("ccdl");

- to describe the "harmonization process" that has recently resulted in significant changes to ccdl in Alberta and should lead to similar changes to the ccdl of all other Canadian jurisdictions–federal, provincial and territorial–in the near future;[1]

- to summarize the Institute's role in the harmonization process, as part of our responsibility to report on the Institute's law reform activities;

- to suggest areas in which there may be scope for improvement of Canadian ccdl without departing from policies that have recently been agreed to by all Canadian jurisdictions.

[2] Between 1987 and September 1, 1999, Alberta's ccdl was embodied in the *Consumer Credit Transactions Act* ("CCTA"). On the latter date the CCTA was repealed by the *Fair Trading Act* ("FTA"). Cost of credit disclosure in Alberta is now governed by Part 9 of the FTA and its associated regulation, the *Cost of Credit Disclosure Regulation* ("CCDR").

[3] None of the provisions of FTA Part 9 (or any other provisions of the FTA) is based on a formal recommendation of the Institute. Indeed, as explained later in this report, at a fundamental level FTA Part 9 departs from the approach the Institute would have recommended. Nevertheless, although the Institute has not made any formal recommendations on the content of ccdl, we have provided

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[1] The projected implementation dates for harmonized cost of credit legislation in different Canadian jurisdictions are set out on the Industry Canada web site at <http://strategis.ic.gc.ca/SSG/ca01086e.html>.

considerable input into the process that lies behind the enactment of FTA Part 9. We are therefore in a position to provide an overview of that process and its results.

[4] After this introduction the report is divided into four main sections plus a brief conclusion. The first of these, section B provides an overview of ccdl. It briefly describes the objectives and evolution of such legislation, with an emphasis on the harmonization process that lies behind FTA Part 9. Section C then describes the broad contours of FTA Part 9.

[5] Section D returns to the harmonization process to discuss a controversy that arose during that process. The controversy related to mandatory disclosure of the annual percentage rate ("APR"). Mandatory APR disclosure has been a central feature of Canadian (and other countries') ccdl since the 1960s. In the early nineties, however, ALRI and Uniform Law Conference of Canada ("ULCC") proposed to move away from mandatory APR disclosure in most contexts. Ultimately, the officials responsible for determining the policy to be implemented by harmonized ccdl decided to retain mandatory APR disclosure. Nevertheless, we think it is worthwhile to describe in general terms why ALRI-ULCC were proposing to abandon mandatory APR disclosure (in most contexts) and what we were proposing in its place.

[6] Section E makes some suggestions as to aspects of FTA Part 9 where there appears to be scope for improvement within the framework of the policies that have recently been agreed to through the harmonization process. The suggestions in section E are not that the Alberta government should unilaterally make any particular changes to FTA Part 9 or the CCDR. Rather, they are suggestions about areas in which coordinated tinkering by Alberta and other Canadian jurisdictions may be appropriate.

B. Overview of Cost of Credit Disclosure Legislation

1. Origins and Objectives

[7] The cost of credit has been a topic of concern to legislators for centuries. This concern has traditionally been expressed in legislation imposing ceilings on the cost of credit in various contexts: particularly, but not necessarily, in the context of consumer loans. A good example of this sort of approach is the now-repealed *Small Loans Act*,[2] which imposed rate caps on consumer loans for modest amounts. Similarly, until 1967 banks were limited to a 6% rate of interest or discount in respect of any loan or advance payable in Canada.[3] Section 347 of the *Criminal Code* is a subsisting example of this approach.[4] This section makes it an offence to enter into an agreement to receive interest[5] at an effective rate in excess of 60%. The section applies to any credit arrangement, not just to consumer loans.

[8] Cost of credit disclosure legislation is a different manifestation of legislators' concern about the cost of credit. The basic rationale for such legislation is that it provides borrowers (or prospective borrowers) with a better opportunity than they would otherwise have to advance their own interests by making rational, well-informed credit-purchasing decisions:

> There are at least four ways in which statutory rate information may facilitate the rational purchase of credit: firstly, it may assist in the choice between using credit and paying cash for a purchase, by enabling the debtor to compare the cost of credit with the interest which would be foregone on accumulated savings if he were to pay cash; secondly, assuming the debtor is committed to using credit, it may help him to locate the cheapest credit source available to him; thirdly it may act as a warning to the debtor that the cost of a transaction he is contemplating is unusually high; and finally, because the legislation requires the disclosure of an annual percentage rate calculated according to a prescribed statutory method ("APR"), it may

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[2] R.S.C. 1970, c. S-11; repealed by S.C. 1980-81-82-83, c. 43, s. 8 (repeal effective September 1, 1994: SI/94-115). The Act was kept alive until 1994 for transitional purposes.

[3] *Bank Act*, S.C. 1953-54, c. 48, s. 91(1). The ceiling was eliminated in 1967 revisions of the *Bank Act*: S.C. 1966-67, c. 87, s. 91.

[4] R.S.C. 1985, c. C-46, s. 347.

[5] The definition of "interest" for section 347 is very broad: see *ibid*. s. 347(2). It includes charges that the FTA treats as "non-interest finance charges," rather than interest.

> protect the debtor from being misled into comparing rate figures calculated on different bases.[6]

In short, ccdl is intended to make it easier for consumers to get timely, comparable information about the cost of credit from different credit grantors. To the extent that it relies on well-informed borrowers making rational credit purchasing decisions, ccdl places more faith in market mechanisms than does legislation that imposes quantitative restrictions on credit charges.[7]

[9] Sections 4 and 6 of the *Interest Act* (Canada) are early examples of ccdl. The former originated in 1897 and the latter's direct ancestor was enacted even earlier, in 1880. We have no intention of examining the history of either of these sections here.[8] It suffices to observe that both are aimed at requiring standardized disclosure of the annual interest rate for certain types of loan, and that both deal only with interest in the narrow sense: charges that accrue over time at a specified rate. Thus, an interest rate disclosed in accordance with either of these sections will tell you nothing about the impact of various lump-sum charges that might be associated with and form a significant proportion of the total cost of a particular loan.

[10] In the years following the Second World War the increasing use of consumer credit caused policy makers to pay increasing attention to disclosure of the cost of credit. In Alberta this concern first manifested itself in *The Credit and Loans*

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[6] Duggan 1984.

[7] There has been a long, ongoing debate over whether requiring credit grantors to disclose certain information, such as the APR, to consumers will actually benefit the latter. Some of the issues in the debate are (1) whether there is really an information problem in the absence of legislated disclosure requirements; (2) whether consumers will understand the disclosed information; (3) whether consumers will get the information in time to make use of it, even if they do understand it; (4) whether consumers will actually make use of the information, even if they do understand it; (5) whether markets will be made more competitive by mandatory disclosure. The following (listed in more or less chronological order) are a few of many direct or indirect contributions to the discussion: Stigler 1961 (which does not discuss cost of credit disclosure *per se* but which provides a starting point for economic analysis of the effect of imperfect information on markets); Jordan & Warren 1966; Ziegel 1968; Kripke 1968; Kripke 1969; Whitford 1973; Brandt & Day 1974; Landers & Rohner 1979; Schwartz & Wilde 1979; Beales, Craswell & Salop1981; Kofele-Kale 1984; Duggan 1986; Duggan 1991 (esp. at 265-68); Rubin 1991; Bowes 1991; Garwood, Hobbs & Miller 1993; Bowes 1997; Lanyon 1997; Blaine & Hogarth 1999.

[8] See Waldron 1992 at 97-115.

Agreement Act of 1954.[9] This act required credit grantors to quantify the credit charges for certain time sale agreements and loans but did not require credit charges to be expressed as an annualized rate.[10]

[11] Continuing public and political concern over the cost of credit, and a perception that consumers often obtained credit without appreciating its true cost, led to a flood of cost of credit disclosure (or "truth-in-lending") legislation beginning in the 1960s. In January 1960 Senator Paul Douglas introduced a bill in the United States Senate that would have required disclosure of the finance charge (i.e. the cost of credit as a dollar amount) and the "true annual interest rate" in consumer credit transactions.[11] A couple of months later Senator David Croll presented a similar bill in the Senate of Canada.[12] Although neither was enacted, these bills helped initiate the process that within a few years led to the enactment of comprehensive ccdl throughout North America and overseas.

[12] Over the years, a primary objective of ccdl has often been seen as making it easier for consumers to compare the cost of credit from different sources of credit. In the early 1960s it was easy to build a case that the task of comparing the cost of credit from different sources was complicated unnecessarily by the multitude of ways that the cost might be stated. In the first place, some credit grantors did not disclose the cost of credit as a time-rate. Consumers might only be told the amount and number of monthly payments or the dollar cost of credit. Even where the cost of credit was disclosed as a time rate, there was no guarantee that the rate disclosed by one credit grantor would be commensurate with the rate disclosed by another.

[13] Some appreciation of the information difficulties faced by consumer borrowers can be gained by considering how Canadian banks disclosed the cost of credit on

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[9] S.A. 1954, c. 19.

[10] Although the 1954 act did not require disclosure of an annualized rate, Alberta seems to have been an early proponent of such disclosure. Neilson 1985 at 73 states that between 1955 and 1963 Alberta and Manitoba "initiated unsuccessful efforts to enact legislation requiring credit charges to be stated in terms of the effective interest rate."

[11] Rubin 1991 at 242-43.

[12] Bill S-25, *An Act to make Provision for the Disclosure of Information in respect of Finance Charges*, 3d Sess., 24th Parl., 1960: see Debates of the Senate (March 16, 1960) at 349.

personal loans. One of the eight different disclosure methods identified in a 1965 Ontario report was labelled as "annual interest rate per cent" and described thus:

> A rate per cent per annum calculated and charged on the unpaid principal balance from time to time either as a simple annual rate or a compound rate. Examples are:
>
> Commercial bank loans
>
> First mortgages
>
> Bonds and debentures
>
> The true or effective rate per cent is usually disclosed to the borrower.[13]

This suggests that banks in those days disclosed the cost of personal loans as a simple annual interest rate. In fact, however, the rate disclosed by banks on personal loans was not a simple annual interest rate.

[14] We have mentioned that until 1967 Canadian banks could not exact a rate of interest *or discount* exceeding 6% per annum on loans payable in Canada. This limit is reflected in an advertisement reproduced in the 1965 Ontario report.[14] The advertisement poses the question, "What does a loan cost me?" It answers, "Six per cent per year deducted in advance." The advertisement sets out tables showing the amount received and the monthly payment amounts for example loans of various face amounts and terms. The data for one such loan is as shown in the box to the right.

Loan Amount	$612.00
Received by Borrower	$501.84
Term (months)	36
Monthly Payments	$17
Total Payments	$612

[15] Since the borrower would only get the use of $501.84, this was in reality a loan for about $501 rather than $612.00. The $612 represented the amount actually lent to the borrower plus the cost of credit, which was deducted in advance. The true nominal annual interest rate on a loan of $501.84 that is paid off in 36 monthly payments of $17 is considerably higher than 6%. In fact, it is 13.4%, or more than twice the stated rate.

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13 Ontario Report 1965 at 29-30 (para. 211).

14 "The difference between hoping and having is a personal loan from the Canadian Imperial Bank of Commerce:" advertisement reproduced in Ontario Report 1965 at 107, Appendix 11.

[16] That the bank's advertisement could sav that the loan cost 6% per year illustrates the lack of standards for calculating and disclosing the cost of credit in the 1960s. The bank's figure of 6% per year was obtained by dividing the total discount ($110.36) by the face amount of the loan ($612.00) and then dividing by the number of years (3) in the term. This is the implication of the qualifier "deducted in advance" in the advertisement. It is an implication, however, that might not be obvious to a consumer who wanted to compare the bank's rate with the rate offered by a credit grantor who disclosed the cost of credit as a true annual interest rate.

[17] Given the latitude enjoyed by lenders of the day in disclosing the cost of credit, it is not surprising that legislators in the 1960s thought they could make it easier for consumers to evaluate and compare the cost of credit. This could be done by requiring all credit grantors, firstly, to disclose the cost of credit as an annualized time rate and, secondly, to calculate this rate in a consistent manner. Thus, the comprehensive ccdl enacted throughout Canada and other jurisdictions beginning in the 1960s uniformly required credit granters to disclose the cost of credit as an annualized time rate and prescribed how this rate was to be calculated.

[18] The annualized time rate was considered to be the best overall measure of the cost of credit for comparative purposes. Legislators also thought it would be useful to require credit grantors to disclose the total dollar cost of credit to bring home to consumers the cost of purchasing on credit, as opposed to paying cash from savings or deferring a purchase until they could pay cash.

[19] Early proposals for ccdl would have done no more than require disclosure of the annualized time rate and dollar cost of credit. For example, the four clauses of the bill introduced by Senator David Croll in 1960 contained but one requirement:

> . . . before the transaction becomes legally binding, [the credit grantor must give the consumer] a clear statement in writing setting forth
>
> (a) the total amount of the finance charges to be borne by that person in connection with that transaction; and
>
> (b) the percentage relationship, expressed in terms of simple annual interest, that the amount of the finance charges bears to the outstanding principal obligation or unpaid balance under the transaction.[15]

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[15] Bill S-25, *An Act to make Provision for the Disclosure of Information in respect of Finance Charges*, 3d Sess., 24th Parl., 1960, cl. 3.

However, the legislation actually enacted in various jurisdictions was much lengthier and required disclosure of considerably more information than would have been required by the original proposals.

[20] In the United States, the process initiated by Senator Douglas' bill culminated in the enactment in 1968 of comprehensive federal ccdl: the *Truth in Lending Act* ("TILA"). In Canada, by the early 1970s federal legislation imposed disclosure requirements on banks and each province had enacted legislation mandating comprehensive disclosure by non-bank credit grantors. This legislation required disclosure of the cost of credit in consumer credit transactions both as an annualized time rate and as a dollar amount. In Alberta, this was accomplished by *The Credit and Loan Agreements Act, 1967*,[16] which replaced the similarly-named act of 1954.

[21] The enactment of comprehensive ccdl was by no means a uniquely North American phenomenon. Although not necessarily devoted exclusively to disclosure of cost of credit, consumer credit legislation enacted in the seventies and early eighties in the United Kingdom,[17] Australia,[18] and New Zealand[19] was largely concerned with this subject. As in North America, mandatory disclosure of the cost of credit as an annualized time rate was a central element of the disclosure requirements in these jurisdictions.

2. The Harmonization Process

[22] The ccdl enacted by Canada (for banks) and the provinces in the 1960s and early 1970s took the same basic approach, with variation in the details from one jurisdiction to the next. Other federal jurisdictions have recognized that there is much to be said for having uniform, or at least consistent, disclosure requirements where a consumer credit market spans jurisdictional boundaries.

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[16] S.A. 1967, c. 11.

[17] *Consumer Credit Act 1974* (U.K.), 1969, c. 39.

[18] See Duggan 1986.

[19] *Credit Contracts Act 1981* (N.Z.). See Dugan 1981. The New Zealand Ministry of Consumer Affairs has recently commenced a root and branch review of consumer credit legislation in that country. New Zealand MCA 1999 is a general overview of the consumer credit market and consumer credit laws. We understand that the Ministry will be publishing a document dealing specifically and in more detail with cost of credit disclosure in April 2000.

[23] In the United States, substantial uniformity was achieved by the enactment of comprehensive federal disclosure legislation: the TILA. In Australia, the consumer credit legislation of the 1970s and 80s was similar from one state to the next. Nevertheless, the differences that did exist were aggravating enough to induce the several states to undertake efforts to achieve uniform consumer credit laws. After several years, these efforts resulted in the adoption of a uniform Consumer Credit Code that came into operation in all the Australian states and territories in late 1996.[20]

a. *Earlier Canadian Harmonization Efforts*

[24] The disadvantages of non-uniform ccdl have not been lost on Canadian governments, and several efforts have been made over the years to harmonize disclosure legislation across the country.[21] One possible approach would be to enact comprehensive federal ccdl in the manner of the US TILA. This approach was in fact tried by the federal government in 1976, when it introduced Bill C-16, the Borrowers and Depositors Protection Act.[22] The bill received second reading, but then languished and died in Committee. Although consumers organizations supported some aspects of the bill, they opposed others. Credit grantors strongly opposed some of its provisions, and provinces objected to portions of the bill on the ground that they infringed upon areas of provincial jurisdiction.[23]

[25] After Bill C-16 died, federal and provincial governments engaged in an informal process aimed at harmonizing disclosure requirements for consumer credit transactions.[24] The process led to an informal commitment by several jurisdictions, including Alberta, to harmonize certain aspects of their ccdl. Over the next few years Canada and several provinces replaced or amended their 1960s-vintage

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[20] Lanyon 1997. One of the interesting aspects of the new Australian code is that it dispenses with disclosure of an APR that accounts non-interest charges: Lanyon 1997 at 226-27. In that respect, the Australian code takes a similar approach to what was proposed by ALRI-ULCC in the early nineties. Unlike the ALRI-ULCC proposals, however, the Australian code does not place any restrictions on non-interest charges.

[21] See Neilson 1985 at 72-82.

[22] Bill C-16, 2d Sess., 30th Parl. 1976.

[23] The Bill's rise and fall is discussed in Neilson 1985 at 76-81. See also, Waldron 1992 at 16-17.

[24] Neilson 1985 at 81-82.

disclosure legislation in accordance with this informal commitment. Alberta did so in 1985 when it enacted the CCTA, which came into force in 1987.

b. The ALRI-ULCC Project

[26] In 1989 Alberta's Minister of Consumer and Corporate Affairs requested the ALRI to consider a project on consumer credit law. The Minister's request referred to dissatisfaction that had been expressed in certain quarters regarding some provisions of the CCTA. The Institute concluded, as a preliminary matter, that it would benefit both credit grantors and consumers if all Canadian jurisdictions enacted truly uniform ccdl. The Institute decided to explore the possibility of conducting a project with this end in mind in cooperation with the ULCC. At its 1990 annual meeting the ULCC decided to undertake a project on ccdl in cooperation with the Institute. The informal arrangement between the ALRI and ULCC envisioned that research and consultation would be carried out and project-related documents prepared mainly through the resources of the former. Decisions on the content of the prospective uniform legislation were to be made in the first instance by the ULCC.

[27] In 1991 the ULCC considered an Issues Paper that proceeded from the assumption that mandatory APR disclosure by credit grantors was and would remain a key requirement of Canadian ccdl.[25] The main APR-related issues, so far as the Issues Paper was concerned, were what charges should be included in or excluded from the APR and, to a lesser extent, the mechanics of calculating the APR.

[28] By 1992, however, ALRI-ULCC were exploring a different approach to cost of credit disclosure, which would not have required credit grantors to calculate and disclose an APR for most credit agreements. As an alternative to mandatory APR disclosure, it was proposed that lenders should generally be required to disclose the annual interest rate and the dollar amount of any non-interest charges that would be payable in connection with a credit arrangement. Moreover, and crucially, it was also proposed that ccdl would include certain non-quantitative restrictions on the non-interest charges that could be imposed in connection with consumer credit arrangements. The general nature and precise definition of the proposed restrictions on non-interest charges were the focus of much of the ALRI and ULCC's attention

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[25] Bowes 1991.

in draft acts and other documents circulated from 1992 through 1995.[26] By that time, however, the ALRI-ULCC proposals had been overtaken by developments in another arena.

c. The Agreement on Internal Trade

[29] In the summer of 1993 the federal, provincial and territorial governments initiated negotiations aimed at reducing trade barriers within Canada. In the fall of 1993 the Institute and ULCC were informed that cost of credit disclosure legislation was on the agenda for the internal trade negotiations, as an aspect of efforts to harmonize consumer related measures.

[30] Upon learning of this intergovernmental initiative, the ULCC decided to delay finalization and adoption of its uniform Cost of Credit Disclosure Act ("CCDA") in order to consult with government officials responsible for the consumer related measures sector of the internal trade negotiations. ALRI-ULCC initially hoped that if the internal trade negotiations were successful, the resulting agreement would contain detailed specifications for the content of uniform ccdl, and that those specifications would conform closely to the proposals that had already been put forward by ALRI-ULCC. But this was not to be.

[31] The Agreement on Internal Trade ("AIT") was signed in the summer of 1994. It called for all Canadian jurisdictions (including Canada) to harmonize cost of credit disclosure legislation but did not specify the detailed content of such legislation. Instead, the AIT called for an agreement on the details of harmonized legislation to be finalized by January 1, 1996 with implementation by January 1, 1997.[27]

[32] The AIT also provided for an inter-jurisdictional committee of government officials called the Consumer Measures Committee ("CMC"). One of the CMC's responsibilities was to work out the details of harmonized ccdl. To this end, the CMC set up an informal working group on cost of credit disclosure ("Working Group").

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[26] See e.g. Bowes 1993.

[27] AIT, Annex 807.1, paragraph 10.

[33] By the time the AIT was signed it was apparent to the ALRI and ULCC that policy decisions on the content of harmonized ccdl would effectively be made by the CMC and its Working Group. There appeared to be no point in the ULCC adopting a uniform CCDA based on its own views as to what was or was not appropriate cost of credit disclosure policy. Therefore, ALRI-ULCC had two realistic alternatives. One would be to drop out of the process altogether. The second would be to stay in the process for the purpose of (1) offering input on policy issues to the Working Group and (2) developing a uniform act to give effect to the policy decisions reached by the CMC. After some reflection, ALRI-ULCC adopted the latter alternative.[28]

[34] It took longer for the parties to the AIT to reach an agreement on the details of harmonized ccdl than had been anticipated by the AIT. In the summer of 1995 the Working Group circulated a consultation document called *Proposals for Harmonization of Cost of Credit Disclosure Laws in Canada*.[29] This document rejected the ALRI-ULCC proposal to turn away from mandatory APR disclosure. Instead, it proposed to retain the basic approach of existing Canadian legislation, with its emphasis on mandatory APR disclosure. To be more precise, it proposed that lenders should continue to be required to disclose the APR for fixed credit (e.g., a single-advance loan or credit sale that is to be paid off in accordance with a predetermined schedule of payments). However, acknowledging that it is impractical to calculate and disclose a realistic APR for open credit facilities (e.g., a line of credit or credit card account), the Working Group's consultation document did not propose to require lenders to disclose an APR for open credit.[30]

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[28] ALRI-ULCC representatives participated in many meetings and telephone conferences of the Working Group in the period between the signing of the AIT (1994) and the finalization of the Harmonization Agreement (1998). In addition, ALRI provided the Working Group with a variety of discussion documents (some solicited, some not). Some of the more substantial documents are included in the "Works Cited" table at the beginning of this report: ALRI 1995 (1); ALRI 1995 (2); ALRI 1995 (3); ALRI 1995 (4); ALRI 1995 (5); ALRI 1997.

[29] Working Group 1995.

[30] Working Group 1995 at 10. The paper does not specifically say that APR disclosure would not be required for open credit. Instead, it says that APR disclosure will be required as a "key element of disclosure for fixed credit." In giving reasons for not accepting the ALRI-ULCC suggestion to move away from mandatory APR disclosure, the paper says that "the fact that the APR can not be used for open credit does not diminish its usefulness to consumers in the case of fixed loans:" *ibid.*

[35] In July 1996 the CMC issued a revised version of the Working Group's 1995 document, also entitled *Proposals for Harmonization of Cost of Credit Disclosure Laws in Canada.*[31] The 1996 document affirmed the 1995 consultation document's approach to APR disclosure for fixed credit. However, there was a change with respect to open credit; it was now proposed to require disclosure of the APR for open credit other than credit card agreements.[32] And, in a significant step beyond existing ccdl, the 1996 document proposed to require APR disclosure for all long-term leases of consumer goods.[33]

[36] The CMC's 1996 consultation document determined the basic structure of the eventual agreement on the details of harmonized Canadian ccdl. However, it took another two years for the parties to put the finishing touches on the text of an agreement setting out the details of harmonized ccdl. The *Agreement for Harmonization of Cost of Credit Disclosure Laws in Canada: Drafting Template* ("Harmonization Agreement") was finalized in the summer of 1998. The ULCC, for its part, adopted the uniform CCDA at its annual meeting in August 1998. In keeping with the informal working arrangement between the ALRI and ULCC, the CCDA and its accompanying Commentary were drafted by the former[34] and approved by the latter.

[37] The CCDA as such, was not endorsed by the CMC or incorporated in the Harmonization Agreement. As indicated by its title, the Harmonization Agreement contains what it describes as a drafting template. Most provisions in the drafting template are based on provisions of an earlier draft of the CCDA provided by ALRI-ULCC to the Working Group for discussion purposes. Thus, some provisions of the CCDA are identical to provisions in the drafting template. On the other hand, in some areas there are differences between the language of the CCDA and the language of the Harmonization Agreement's drafting template. In such areas, an implementing jurisdiction's legislative drafter would have to choose between the

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[31] CMC 1996.

[32] CMC 1996 at 4.

[33] CMC 1996 at 21.

[34] We should say that the CCDA was drafted by ALRI with the very considerable assistance of Mr. Peter Pagano, Alberta's Chief Legislative Counsel.

CCDA's approach and the drafting template's approach. Despite their differences in language, however, both the CCDA and the drafting template are intended to implement the policies embedded in the Harmonization Agreement.[35]

d. FTA Part 9 and the Harmonization Process

[38] The Fair Trading Act bill was introduced in the Alberta Legislature in February 1998 and received Royal Assent on April 30 of the same year. Part 9 of the FTA deals with cost of credit disclosure and is designed to fulfill Alberta's commitments under the Harmonization Agreement. Given this design, it may seem odd that the FTA was drafted and enacted before the Harmonization Agreement was finalized in the summer of 1998. The explanation for the peculiar timing is that the Alberta Government considered it necessary to include cost of credit disclosure legislation in the fair trading bill that was going forward in the spring of 1998. Moreover, by the spring of 1998 most details of the Harmonization Agreement had been settled, and those that were unsettled related to matters that could be dealt with by regulations (the CCDR).

[39] It was noted above that there are differences between the CCDA and the Harmonization Agreement's drafting template. Where such differences exist, FTA Part 9 and the CCDR generally follow the CCDA, rather than the drafting template.[36] One implication of the close relationship between the Alberta legislation and the CCDA is that the ULCC's section-by-section Commentary on the CCDA may be useful as an aid to interpreting provisions of FTA Part 9 and the CCDR.

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[35] There is one portion of the CCDA for which there is no parallel in the Harmonization Agreement or the drafting template: compliance provisions. The Working Group discussed the matter of harmonized compliance provisions, but different jurisdictions had different views on what the consequences of non-compliance should be. At some point it was decided that harmonization of ccdl did not necessarily entail harmonization of compliance provisions. The ULCC, however, considered that its uniform act should at least deal with the civil consequences of non-compliance.

[36] The introduction to the Harmonization Agreement makes it clear that compliance with the agreement does not require jurisdictions to use the precise language of the drafting template: "Jurisdictions are committed to adopting the intent of these proposals and will prepare their own legislation and regulations."

C. Contours of FTA Part 9

[40] The matters dealt with by FTA Part 9 may be divided into the following general categories:

- Application of the Part (its scope of operation)
- Categorization of credit arrangements
    - by characteristics of the credit grantor
    - by characteristics of the credit recipient ("borrower")
    - by characteristics of the credit arrangement
- Disclosure requirements
    - Timing of disclosures
    - Format of disclosures
    - Content of disclosures
- Calculation of cost of credit
    - Components of cost of credit
    - Mathematical conventions
- Miscellaneous substantive provisions
- Compliance provisions

[41] The remainder of this section describes the broad contours of FTA Part 9 by summarizing its approach to the foregoing matters. It also points out some similarities and differences between the FTA's approach to these matters and the approach of the now-repealed CCTA. It should be emphasized that this discussion is intended to provide a general overview, rather than a detailed analysis of FTA Part 9 and the CCDR.[37] Unless otherwise indicated, it may be assumed that FTA Part 9's approach to any given issue, if not its precise wording, is determined by the terms of the Harmonization Agreement.

[37] See Mirth 1999 for a more detailed discussion of some of the provisions of FTA Part 9 and the CCDR. Also, since the Alberta legislation is based closely on the ULCC's CCDA, the CCDA Commentary may be of assistance to users of the Alberta legislation.

1. Application of FTA Part 9

a. Characteristics and Purposes of the Borrower or Lessee

[42] FTA Part 9 applies to credit agreements[38] and leases[39] that have certain characteristics. Actually, the criteria focus more on the characteristics and purposes of the borrower and the characteristics of the lender than on the legal characteristics of the credit agreement or lease. The borrower must be a consumer borrower or, more precisely, "an individual who enters into the credit agreement primarily for personal, family, household or farming purposes."[40] Thus, it would not apply to a loan to a corporation, nor would it apply to a loan to an individual that is primarily for business purposes. A credit grantor is entitled to rely in good faith on a statement signed by the borrower regarding the purpose of a credit transaction.[41]

b. Characteristics of the Credit Grantor

[43] FTA Part 9 generally applies only to credit grantors who extend credit in the course of carrying on a business.[42] There is, however, an important exception to this requirement. Even if the credit grantor does not extend credit in the course of carrying on a business, Part 9 applies to a consumer credit agreement arranged by a loan broker.[43] In this latter case, the loan broker is responsible for discharging the duties that would ordinarily fall upon the credit grantor.[44] The theory here is that it

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[38] The term "credit agreement" is defined in FTA section 58(k) as an agreement under which credit is extended, including loans of money and credit sales.

[39] The term "lease" is defined in FTA section 58(w) as an agreement for the hire of goods, other than an agreement for the hire of goods (e.g. appliances) in connection with a residential tenancy agreement.

[40] FTA s. 60(3)(a).

[41] FTA s. 60(4).

[42] FTA s. 60(3)(b). This obviously will take credit arrangements outside of the Act if the credit grantor is not carrying on business at all: for example, a loan between friends or family members where the lender does not carry on any sort of business. However, the mere fact that the credit grantor carries on a business does not mean that an extension of credit will be "in the course of carrying on" that business. The phrase "course of business" is defined in the *Dictionary of Canadian Law*, 2d ed. (Toronto: Carswell, 1995) as "the normal activities of business."

[43] FTA s. 60(3)(b)(ii).

[44] FTA s. 72(1), (2).

is the loan broker, rather than the actual credit grantor, who will be in the best position to make the disclosures required by the Act.

c. *Specific Exclusions*

[44] In most cases, if the borrower is obtaining credit for a consumer purpose and the credit grantor is extending credit in the course of carrying on a business, Part 9 applies to the credit agreement. Under the CCTA, a transaction that would otherwise be covered by the Act might not be covered if the amount advanced to the borrower fell below a threshold or exceeded a ceiling. For example, the CCTA did not apply to mortgage loans where the principal amount exceeded $150,000.[45] In contrast, the amount advanced or to be advanced under a credit agreement is irrelevant when deciding whether FTA Part 9 applies.

[45] The major exception to the comprehensive application of Part 9 to consumer credit arrangements is for what might be referred to as "convenience credit." This is credit extended by sellers of goods or services to their customers on a relatively informal basis. The goods or services must be supplied on the understanding that the consumer will pay for them in full in a single payment within a certain period after receiving an invoice or statement of account. In addition, the credit must be unconditionally interest free during the period for payment, it must be unsecured, it must not be assigned (otherwise than as security), and it must not provide for any non-interest finance charges (e.g. an "administration charge" that would not be payable by a cash customer).[46]

[46] Section 3 of the CCTA provided that most of the provisions of that Act did not apply to certain professional services identified by regulation. The regulation under the CCTA identified about twenty professions that qualified for this exemption.[47] There is no such exemption under the FTA. On the other hand, the terms upon which the professional services are provided could bring them within the "convenience credit" exemption discussed in the preceding paragraph.

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[45] CCTA s. 2(e).

[46] FTA s. 60(5).

[47] Alta. Reg. 307/87, s. 1.

d. Application to Leases

[47] Like the CCTA, FTA Part 9 applies to certain leases of goods. The criteria relating to the characteristics of the borrower and credit grantor that determine whether Part 9 applies to a credit agreement also determine whether it applies to a lease. The lessee must be an individual leasing for consumer (or farming) purposes and the lessor must enter into the lease in the course of carrying on a business.[48] In addition, the lease must either be for a fixed term of four months or more or be for an indefinite term.[49] It is worth noting that the inclusion of leases with an indefinite term (or that are renewed automatically until one of the parties takes positive steps to terminate the lease) means that the typical "rent-to-own" contract will be covered by Part 9.

[48] In addition to the exceptions to Part 9's application that are built into the Act, provision is made for regulatory exemption of some credit agreements to which Part 9 would otherwise apply.[50] Under this authority, the CCDR exempts certain specific types of credit arrangement from the application of Part 9.[51] Most of these were exempted from the CCTA. The only new exemption provided by the CCDR is with respect to "overdraft protection on a deposit account."[52]

2. Categories of credit agreements and leases

[49] This section briefly describes how FTA Part 9 categorizes credit agreements and leases for purposes other than determining the Part's application. FTA Part 9 classifies credit agreements and leases according to two main variables and a few subordinate variables. The two main variables are:

- whether the transaction is a *credit agreement* or a *lease*;
- whether the credit agreement is for *open credit* or *fixed credit*.

These main variables affect the basic divisions of Part 9. Division 3 deals with fixed credit, Division 4 with open credit, and Division 5 with leases.

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[48] FTA s. 60(1), (3).

[49] FTA s. 91. In theory, FTA Part 9 would apply to a "residual obligation lease" (also known as financing leases or open-end leases) regardless of the length of its term–FTA s. 91(c)–but in practice it is unlikely that any residual obligation lease will be for a term of less than four months.

[50] FTA s. 101(2).

[51] CCDR s. 2(1).

[52] CCDR s. 2(1)(e).

a. Credit Agreements and Leases

[50] The definition of "credit agreement" in FTA section 58(k) is broad enough–applying to "an agreement under which credit is extended"–that it might be construed as applying to an ordinary long-term lease of consumer goods.[53] If this were so, the provisions dealing with "credit agreements" would also apply to leases. However, it seems clear that, for the most part, FTA Part 9 intends to treat leases and credit agreements as mutually exclusive categories. The fact that Part 9 devotes a separate division to leases indicates that it was not intended that most of the provisions applicable to ordinary credit agreements would apply to leases. Further evidence of this intention is that where certain provisions that refer to credit agreements are clearly intended to apply to leases, the Act specifically states that the term "credit agreement" is to be read as including leases.[54]

b. Open Credit and Fixed Credit

[51] The categories of fixed credit and open credit are mutually exclusive, since the definition of "fixed credit"basically says that fixed credit is not open credit.[55] The definition of "open credit" identifies three characteristics of this type of credit:

- the credit agreement anticipates multiple advances;
- advances are made when the borrower requests them (for example, by presenting a credit card to a merchant to pay for merchandise or services or by writing a cheque on a line of credit);
- the credit agreement does not limit the total amount of the advances that the borrower may receive under the credit agreement, although it may impose a limit on the balance that may be outstanding at any time.[56]

So far as FTA Part 9 is concerned, the two major forms of open credit are credit card agreements and lines of credit.[57]

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[53] There seems to be little doubt that an agreement that describes itself as a "lease" but which is in substance a credit sale–because the "lessee" is essentially committed to paying the full value of the goods over time–could be treated as a credit agreement, rather than a lease, under the FTA. The question here is whether a "true" lease could also be regarded as falling under the FTA's definition of "credit agreement."

[54] FTA ss 60(1), 61.

[55] FTA s. 58(p).

[56] FTA s. 58(z).

[57] Prearranged overdraft facilities are also important forms of open credit. However, as noted earlier,

(continued...)

[52] The paradigm of fixed credit is a loan of a specific amount of money or a credit sale where the amount borrowed or the unpaid balance of the purchase price is to bear interest at a fixed rate and is to be repaid in a certain number of equal periodic payments. Leaving aside the possibility of default, prepayment or amendment of the credit agreement, the borrower under such a credit agreement can be told at the outset of the relationship exactly how much they will have to pay to the credit grantor and when. But many agreements for fixed credit will not fit this paradigm.

[53] A credit arrangement with any of the following characteristics is fixed credit, because it does not meet all of the criteria of the definition of "open credit:"

- a credit agreement for a fixed amount of credit, with a variable interest rate;
- a loan for a fixed or maximum amount that is to be advanced in several instalments (as in a construction loan);
- a loan for a fixed amount where the principal is not to be repaid in accordance with a fixed payment schedule, but on demand.

Such credit arrangements, although classified as fixed credit, lack the certainty about the amount and timing of the future payments that characterizes the paradigmatic example of fixed credit. Obviously, this puts a limit on the information that can be conveyed to the borrower about the amount and timing of future payments and the cost of credit.

[54] We mentioned that in addition to the major variables by which FTA Part 9 classifies credit agreements and leases, there are also several subordinate classifications:

- whether the credit agreement is or is not a *mortgage loan*;
- whether the credit agreement is or is not a *credit sale*;
- whether fixed credit is or is not a *scheduled-payments credit agreement*;
- whether open credit is or is not associated with a *credit card*;
- whether a credit agreement is or is not arranged by a *loan broker*;
- whether a lease is or is not a *residual obligation lease*.

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[57] (...continued)
overdraft facilities are excluded from the application of Part 9 by CCDR s. 2(1)(e). Another form of open credit is the traditional "revolving account" (or as the CCTA put it, a "continuous deferred payment plan") offered by retailers. Nowadays, however, it is unusual for retailers to offer revolving account credit that is *not* associated with some sort of credit card.

The following paragraphs briefly describe the contexts in which each of these dichotomies affects the disclosure requirements or substantive provisions that apply to a credit agreement or lease.

c. Mortgage Loans and Non-mortgage Credit Agreements

[55] CCDR section 1(3)(b) defines a "mortgage loan" as a loan of money secured by a charge against real property. The distinction between mortgage loans and other credit agreements does not affect the content or form of disclosure requirements. It does, however, affect prepayment rights and the timing of required disclosures. The Act gives borrowers a right to prepay credit arrangements other than mortgage loans.[58] On the other hand, there are advance disclosure requirements for mortgage loans that do not apply to other forms of credit.[59]

d. Credit Sales

[56] A credit sale is the purchase of a product (goods or services) that is financed by the seller or the manufacturer of the product or an associate of the seller or manufacturer.[60] For the most part, the distinction between a credit sale and a loan of money is not important for the purposes of Part 9. In particular, there is no equivalent in the FTA of the CCTA's prohibition of variable interest rates in time sale agreements.[61]

[57] We have already mentioned that Part 9 does not apply to certain credit sales, which we referred to as "convenience credit."[62] Assuming that Part 9 does apply, the distinction between credit sales and loans of money is relevant only in a few contexts. Section 75 provides that a credit sale must be a scheduled-payments credit agreement. All this means is that the terms of a credit sale must specify a presumptive schedule for payment of the outstanding balance, rather than making

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[58] See section C.5.a below.

[59] See section C.3.a.ii below.

[60] FTA s. 58(n).

[61] CCTA s. 21(5).

[62] See para. 45 above.

this balance payable "upon demand" or at some other indeterminate point in time.[63] It should be noted that this requirement has no application to credit sales under an agreement for open credit, since section 75 appears in Division 3, which applies only to fixed credit.

[58] The actual disclosure requirements that apply to a credit agreement are largely uninfluenced by whether it is a credit sale or a cash loan. One minor difference is that, for obvious reasons, the requirement to disclose the "description of the product" (the goods or services) in the initial disclosure statement for fixed credit applies only to a credit sale.[64] Another difference is that slightly more information may be required in an advertisement relating to a proposed credit sale than in an advertisement for a cash loan.[65]

e. Credit Cards

[59] The Act's definition of "credit card" refers to a "card or device that can be used to obtain advances[66] under an agreement for open credit. It would seem, then, that so long as a consumer who enters into an open credit arrangement is issued with a card that can be used to draw upon the credit facility, the card is a "credit card." The Act makes no distinction between "two-party" cards–cards issued by a merchant to its customers and which can be used only to make purchases from that merchant–and "three-party" cards–cards issued by financial institutions that can be used to obtain products from any of a vast number of merchants who accept the card.

[60] For the most part, credit grantors who extend open credit are subject to the same disclosure requirements whether a credit card is issued in connection with the

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[63] See FTA s. 58(dd). The disclosure requirements for scheduled-payments credit agreements are somewhat more extensive than for fixed credit arrangements (e.g. demand loans) that do not fall within this category. For obvious reasons, the latter are not required to disclose such items as the amount and timing of payments, but are required instead to disclose the circumstances in which the outstanding balance must be paid: CCDR s. 8(2).

[64] CCDR s. 8(1)(a).

[65] CCDR s. 6(3).

[66] This is not limited to a cash advance, as distinguished from the purchase of goods or services. The term "advance" is defined in FTA s. 58(a) as value received by the borrower within the meaning of section 59(3). Clause 59(3)(c) makes it clear that the value received by the borrower could be either money or goods or services.

open credit arrangement or not. However, if a credit card is *not* issued in conjunction with the relevant open credit agreement, then the credit grantor is required to disclose the APR for the credit agreement in the initial disclosure statement. On the other hand, certain disclosure requirements that apply to credit cards do not apply to open credit that is not associated with a credit card.[67] Perhaps the most important provision in the FTA that applies specifically to credit cards is the limitation on the card holder's liability for unauthorized use of a lost or stolen card.[68]

f. Credit Arranged by Loan Brokers

[61] We have noted that certain credit transactions to which FTA Part 9 would not otherwise apply, because the credit grantor is not in the business of extending credit, will be covered by Part 9 if the credit agreement is arranged by a loan broker. The involvement of a loan broker in a credit transaction may also affect the content of disclosure statements. For this purpose, a distinction must be made between loans involving a credit grantor (typically, a financial institution) who enters into the credit agreement in the course of carrying on a business and loans involving credit grantors who are not in the credit granting business.

[62] Where the credit grantor does not extend credit in the course of carrying on a business, then the scheme of Part 9 is essentially to transfer the disclosure obligations that would otherwise fall upon the credit grantor to the loan broker.[69] The only effect of the broker's involvement on the borrower is that, if the borrower is required to pay a brokerage fee, then the initial disclosure statement must disclose the amount of the fee and account for it in the APR and total (dollar) cost of credit.[70]

[63] Things are somewhat more complicated where a loan broker is involved in arranging a loan in which the credit grantor enters into the transaction in the course of carrying on a business. In such cases, the credit grantor's disclosure obligations

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[67] FTA ss 87, 88; CCDR s. 15.

[68] FTA s. 89. See section C.5.d below.

[69] FTA s. 72(2).

[70] FTA s. 72(3).

are not transferred to the broker. The broker may or may not be required to provide a disclosure statement, depending on the extent of the broker's involvement in the transaction.

[64] If the broker "takes a loan application from a borrower and forwards it to the credit grantor," the broker must provide the borrower with an initial disclosure statement.[71] A broker whose involvement in a transaction is limited to referring a prospective borrower to a prospective lender is not required to provide a disclosure statement to the borrower, even if the broker charges for this service. However, the nature of the services provided by loan brokers is such that their involvement will generally extend at least as far as taking the borrower's application for a loan and forwarding it to the lender for consideration.

[65] The fact that a broker has provided an initial disclosure statement does not necessarily discharge the institutional lender's duty to provide a disclosure statement to the borrower. The lender has the option of adopting the broker's disclosure statement as its own or of providing its own disclosure statement.[72]

[66] The credit grantor's disclosure statement is required to account for a brokerage fee payable by the borrower *only* if the brokerage fee is deducted by the credit grantor from the amount advanced to the borrower.[73] Suppose, for example, that the credit grantor advances the proceeds of a mortgage loan to the borrower's lawyer, who then pays the brokerage fee out of the proceeds of the loan in accordance with directions given by the borrower. In this case, it would not appear that the credit grantor's disclosure statement is required to account for the brokerage fee, since the credit grantor did not deduct the brokerage fee from the amount advanced to the borrower's lawyer.

3. Disclosure Requirements

[67] In this section we briefly consider how FTA Part 9 addresses the following questions. At what point in time or in what contexts must credit grantors disclose

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[71] FTA s. 73(3).

[72] FTA s. 73(4).

[73] FTA s. 73(2).

information to borrowers or prospective borrowers? What requirements must be satisfied with respect to the form of disclosure statements? What must be disclosed? We emphasize that we deal with these issues at a general level, rather than in detail.

a. *Timing*

[68] FTA Part 9 requires disclosure of cost of credit information in two main contexts: (1) in advertisements; (2) for particular credit agreements. Transaction-specific disclosure can be further subdivided into disclosure that is required at the outset of the credit relationship and subsequent disclosure that may be required over the course of the relationship. Subsequent disclosure may be triggered by a specific event (e.g. an amendment to the credit agreement) or may be required on a periodic basis.

[69] There is not much to be said about the timing of disclosure in relation to advertising. An advertisement that simply states that credit is available or that goods may be leased is not required to disclose any information about the cost of the credit or lease. Advertising disclosure requirements are triggered by statements about the cost of the credit or lease to which the advertisement relates.[74] If an advertisement contains certain statements about the cost of credit or the cost of the lease, it must disclose other information to put the volunteered information in context.[75]

[70] The timing of disclosure is more of an issue in the context of specific credit arrangements. A major avowed purpose of ccdl is to facilitate informed decision-making by consumers regarding the purchase of credit. If a consumer is to make use of cost of credit disclosure for this purpose, the disclosure should come at a point in time when the consumer has a realistic prospect of using the information in making the credit-purchasing decision. The consumer will not be able to use the information for this purpose if they are effectively locked into a credit arrangement before they have an opportunity to consider the information.[76] This point has

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[74] FTA ss 76(1), (2) (fixed credit), 83(1) (open credit), 92 (leases).

[75] CCDR ss 6, 7 (fixed credit), 12 (open credit), 18 (leases).

[76] One of the major issues discussed in the literature on ccdl is whether there is any reasonable
(continued...)

different implications in the context of mortgage loans than in the context of non-mortgage credit. The difference arises because of the different approach of the Act to prepayment of mortgage loans and non-mortgage credit.

i. Credit Agreements other than Mortgage Loans

[71] FTA section 64(1) requires the disclosure statement for a credit agreement other than a mortgage loan to be given to the borrower before the latter enters into or makes any payment in connection with the credit agreement.[77] The section does not require the disclosure statement to be given to the borrower any particular amount of time before entering into the agreement. It goes without saying that few consumers who are given a disclosure statement a few seconds before they sign a credit agreement will be able to give serious consideration to the information in the statement before signing the agreement. So of what possible use will the disclosures be in the consumer's credit purchasing decision? The answer lies in the generous prepayment right provided to the non-mortgage borrower by the FTA.

[72] As will be discussed in a little more detail below,[78] the FTA gives consumers the right to prepay credit agreements other than mortgage loans at any time without penalty.[79] Moreover, the consumer who prepays a non-mortgage credit agreement will be entitled to a proportionate refund of any non-interest finance charge paid in connection with the credit agreement.

[73] The significance of the consumer's prepayment right to the issue of the timing of disclosure is that the consumer is never locked into a non-mortgage credit agreement. Of course, the consumer who has entered into a credit agreement is under an obligation to repay the outstanding principal. But a consumer who finds that another credit grantor is offering a lower rate of interest than they are

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[76] (...continued)
prospect that consumers who are given cost of credit information by a credit grantor immediately before entering into the transaction will actually make use of that information for "credit-shopping" purposes. It is often remarked that even if the consumer is not legally committed to entering into a credit arrangement with the credit grantor who is giving them the information, they may well be psychologically committed to the transaction. See e.g. Landers & Rohner 1979 at 715-16.

[77] FTA s. 64(1).

[78] See section C.5.a below.

[79] FTA s. 68.

paying on their current credit agreement can refinance their indebtedness at the lower rate of interest. Therefore, even if the initial disclosure statement is given to a consumer the moment before they enter into the credit agreement, they still may use the information "down the road" in deciding whether to refinance the credit agreement through a different lender.

ii. Mortgage Loans

[74] The FTA provides no prepayment right for mortgage loans. Once a consumer has entered into a mortgage, their prepayment privileges, if any, are limited to those provided by the contract and the *Interest Act*.[80] Where a prospective mortgage loan is "closed" or would involve significant non-refundable front-end charges, the borrower can use cost of credit disclosures in their credit-purchasing decision only if they receive the disclosures before they are locked into the mortgage or have incurred the non-refundable charge. Borrowers who received a disclosure statement a few moments before being asked to sign a mortgage or to make a non-refundable payment would not have much opportunity to use the disclosures in deciding whether to enter into the transaction.

[75] With the foregoing in mind, FTA section 64(1) requires the disclosure statement for a mortgage loan be delivered to the borrower two business days before the borrower incurs any obligations or makes any payments in connections with the loan. There are exceptions to this requirement. A "built-in" exception is that obligations or payments for charges such as appraisals or land titles searches do not trigger the advance disclosure requirement.[81] In addition, CCDR section 5 allows the borrower to waive the two-day advance disclosure requirement under certain circumstances: (1) if the borrower has received independent legal advice; (2) the mortgage loan is freely prepayable; *or* (3) the obligation or payment that would otherwise have triggered the advance disclosure requirement will be extinguished or refunded if the borrower decides within two days of receiving the disclosure statement to withdraw from the transaction.

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[80] Section 10 of the *Interest Act* applies to mortgages with a term in excess of five years. Once more than five years of the term has elapsed, the borrower may prepay the mortgage principal upon paying three months' interest "in lieu of notice."

[81] This is the effect of the reference in section 64(2) to "a charge referred to in section 59(3)(f)." It may be noted that the exception for appraisals is conditional on the borrower receiving the appraisal report and being free to give the report to a third party: s. 59(2)(f)(ii).

[76] The FTA also provides for advance disclosure when a mortgage loan is renewed.[82] At least 21 days before the end of the term of an existing mortgage loan, the credit grantor must advise the borrower whether it is willing to renew the mortgage for a further term.[83] If (as will generally be the case), the lender is willing to renew the mortgage, it must provide certain information about the terms upon which it is willing to do so.[84]

iii. Disclosure Relating to Amendments and Interest Rate Changes

[77] The timing requirements for delivery of the initial disclosure statement do not depend on whether the credit agreement is for fixed credit or for open credit. However, some disclosure requirements apply specifically to fixed credit and others to open credit. Apart from the requirement relating to renewal of mortgage loans, there are several circumstances in which a credit grantor may be required to disclose information after providing the initial disclosure statement. The two major circumstances involve floating rates and amendments to a credit agreement. If the interest rate is a floating rate,[85]the credit grantor must, at least once every 12 months, provide the borrower with the prescribed information about the interest rate.[86] If a credit agreement is amended in a manner that changes information provided in an earlier disclosure statement, the credit grantor must provide a supplementary disclosure statement within 30 days after the amendment.[87] The supplementary disclosure statement must provide information about the changed information, but is not required to repeat information that was not affected by the amendment.[88]

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[82] FTA s. 80.

[83] This requirement applies, of course, only if the the mortgage will not be fully amortized at the end of the current term.

[84] FTA s. 80(2), CCDR s. 10(1).

[85] The term "floating rate" is defined in FTA s. 58(q). Essentially, it is a rate that moves up and down in tandem with an "index rate." "Prime + 2%" would be an example of a floating rate, provided that the rate identified by the term "prime" satisfies the publication requirements set out in CCDR s. 1(2).

[86] FTA s. 78(1); CCDR s. 9(1). The disclosure requirements for variable rates that fall outside the definition of "floating rate" are somewhat more onerous: FTA s. 78(2); CCDR s. 9(2).

[87] FTA s. 79(1).

[88] FTA s. 79(2).

[78] Although FTA section 78 bears the marginal note "changes in interest rate," subsection 78(3) requires disclosure in a circumstance that has nothing at all to do with changes in interest rates. It applies in circumstances that presumably will rarely arise. And where the circumstances do arise, the required disclosure is one that most self-interested credit grantors would make whether required by law to do so or not.

[79] Anyone who has ever taken out a loan with a long amortization period will know that during the early part of the period, the greatest proportion of each payment is applied to accrued interest. Only a tiny proportion remains to be applied against principal. Given the thin margin between payment and interest, it follows that a relatively small increase in outstanding principal could cause the interest that accrues in a period to exceed the payment due at the end of the period. Such a situation could arise if the borrower misses a payment early in the amortization period, and the interest on the missed payment is added to principal.[89] If there were no changes in the amount of succeeding payments, the principal outstanding would gradually increase, rather than gradually decrease.[90] If such a situation arises, section 78(3) requires the credit grantor to bring it to the borrower's attention. As already mentioned, this is something that most credit grantors would be only too happy to do anyway.[91]

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[89] A single missed payment will result in "negative amortization" only if the interest rate is quite high. In the example in the following note, negative amortization would not result from a single missed payment if the nominal interest rate was 17% rather than 18%.

[90] For example, suppose that a $100,000 mortgage loan has 25-year amortization period, a 10-year term, and an 18% (nominal) annual interest rate (about 18.7% "calculated half-yearly not in advance"). The monthly payments are $1517.43. The balance outstanding at the end of the term will be $94,225.67. Suppose that the borrower makes the first 12 payments as scheduled, misses the 13th, and then makes all of the remaining payments as scheduled until the end of the term. Because of compounding of the interest portion of the missed 13th payment, the payment made at the end of period 14 will fall $1.61 short of the interest that accrues during that period. This $1.61 will be added to principal. All payments thereafter will fall short of accrued interest for the relevant period by a gradually increasing amount. Therefore, rather than the balance outstanding at the end of the term being $94,225.67, it will be$101,697.60. Of course, part of the difference will be due to the fact that the borrower has only made 59 payments, rather than 60 (having missed the 13th), but most of the difference represents the result of compounding of interest on the missed payment.

[91] The provision appears to be intended to deal with the possibility that an unscrupulous lender whose high-interest rate loan is well-secured might be content to let the outstanding principal build up for an extended period of time.

iv. Periodic Disclosure for Open Credit

[80] FTA section 85(1) requires the credit grantor to deliver a statement of account for an open credit agreement to the borrower at least monthly. Section 85(2) relieves the credit grantor of this requirement under certain circumstances, such as where there has been no activity on the account during the relevant period.

v. Credit Card Applications

[81] For the most part, the FTA treats a credit card account much like other forms of open credit (such as a line of credit). However, a credit card issuer is required to disclose certain information to a prospective card holder in a credit card application form.[92] The information to be disclosed in the application form is information that would in any event be disclosed in the initial disclosure statement. The latter, however, only has to be provided before the consumer makes any payments or incurs any obligations in connection with the agreement.[93]

b. Form

[82] The FTA does not take a highly prescriptive approach to the form in which disclosures are made. Instead, it sets out what might be described as a general performance standard for the presentation of disclosure documents. A disclosure statement–

> must express the required information clearly, concisely in a logical order and in a manner that is likely to bring the information to the borrower's attention.[94]

It is left to credit grantors to design their disclosure forms to meet this standard. Provision is also made for delivery of the disclosure statement through media other than paper, so long as the borrower consents and will be able to retain the disclosure statement for future reference.[95]

[83] The CCTA prescribed two forms for disclosure statements: Form 1 for non-mortgage loans and Form 2 for mortgage loans. These documents would be separate documents from the documents that the parties would regard as the loan

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[92] FTA s. 87(1); CCDR s. 15.

[93] FTA s. 64(1).

[94] FTA s. 63(1)(b).

[95] FTA s. 63(1)(a).

contract. The FTA allows a credit grantor to take this approach: providing disclosure in a separate document that is treated as something separate from the contract document.[96] On the other hand, FTA section 63(1) specifically provides that a disclosure statement may be "part of another document," which might be the contract document.

[84] The CCDR takes essentially the same approach to the form of disclosures in advertising as the Act itself takes to the form of transaction-specific disclosure statements. It does not specify minimum type sizes or the specific position of certain information in an advertisement, an approach that would not lend itself to the variety of media in which advertisements may be conveyed. Instead, where the APR must be disclosed in an advertisement, it must be as "prominent" as the information whose inclusion in the advertisement triggered the requirement to disclose the APR.[97] Other required information must be "conspicuous."[98]

c. Content

[85] We have dealt with the timing and form of the disclosures required by the FTA. This leaves the question of what information must be disclosed in disclosure statements or advertisements. There is, however, really no way to provide a summary answer to the foregoing question. The FTA, like its predecessor and like cost of credit disclosure legislation in other jurisdictions, sets out lengthy lists of information that must be disclosed in various types of disclosure statement or advertisement.[99] These lists are not susceptible to useful summarization.

[86] Although we will not attempt to summarize the various disclosure lists in the CCDR, it is worth observing that the disclosure items in the lists can be divided into two rough categories. The first category consists of what might be described as *primary data*. This is essentially information about the terms of the contractual relationship between the borrower and credit grantor. As such, it is information

[96] However, the disclosure statement may override the contract documents if the former contains information that is more favourable to the borrower than the latter: FTA s. 97.

[97] CCDR, s. 4(a).

[98] CCDR, s. 4(b).

[99] Actually, the lists are found in the CCDR, rather than the FTA itself.

that would almost certainly be disclosed in a well drafted credit agreement, FTA or no FTA. Examples of such disclosure items include a description of the product for a credit sale,[100] information about the interest rate,[101] and a description of the subject-matter of any security interest.[102]

[87] The second category could be described as *secondary data*. This is information that (apart from the FTA) would not necessarily be disclosed in a document whose sole purpose was to describe the contractual rights and responsibilities of the parties. Rather than being information that must be disclosed as part of the process of defining the contractual rights and obligations of the parties, it is information that either can be derived from the primary contractual information (perhaps when combined with certain assumptions about the course of future events) or that provides a context for interpreting the primary contractual information.

[88] To illustrate the foregoing, suppose that a consumer borrows $5,000 at a nominal annual interest rate of 12%. The loan is to be paid off in 24 monthly payments of $235.37. The borrower paid a $50 application fee when they applied for the loan. Disclosure requirements aside, the loan contract would almost certainly set out the amount borrowed, the interest rate and the amount, timing and number of payments. However, it would not necessarily disclose the background information that the borrower paid a $50 application fee.[103] Nor would the loan contract necessarily disclose such derivative information as total payments, total cost of credit ("TCC"), and APR.[104]

4. Cost of Credit Disclosure and Calculation

[89] In the preceding paragraph we referred to the FTA's requirement for credit grantors to disclose certain derived information. The complexity of ccdl is largely attributable to its requirement for credit grantors to disclose two types of derived

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[100] CCDR, s. 8(1)(a).

[101] CCDR, s. 8(1)(g).

[102] CCDR, s. 8(1)(q).

[103] CCDR, s. 8(1) (b), (c).

[104] CCDR, s. 8(1)(m)-(o).

information: (1) the TCC and (2) the APR. Most of the complexity arises from APR disclosure.

[90] In section D below we describe the debate that occurred during the harmonization process as to whether Canadian ccdl should continue to require credit grantors to calculate and disclose an APR. And other papers provide a detailed description of the process of calculating the APR.[105] Given these other discussions, this section stays clear of the policy issues raised by mandatory APR disclosure as well as the details of APR calculations. Instead, it briefly summarizes what the TCC and APR represent, the circumstances in which credit grantors must disclose them, and complications that arise in calculating them.

a. What are the TCC and APR

[91] The TCC and APR are two different measures of the total cost of credit for a credit arrangement. In theory, at least, both measure the total cost to the consumer of the "privilege" of getting some form of credit: the use of money over time or the use of goods or services before they are paid for in full. They both measure the cost of credit by comparing value *received* by the consumer in connection with a credit transaction with the value *given* by the consumer in connection with the transaction.[106]

[92] The TCC is an absolute measure of the cost of credit. It simply tells you how much the credit costs in dollars. The APR is a relative measure of credit cost; it accounts not only for the dollar cost of credit but also the amount of credit extended and the period for which the credit, or any given portion of the credit, is outstanding. Because the APR accounts for more variables than the TCC, it is more complicated to calculate and allows more room for argument as to the "best" way to calculate it.

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[105] The following papers discuss different approaches to calculating the APR, including approaches that are not mandated by the FTA and CCDR: ALRI 1994; ALRI 1995 (4). The following papers are more closely geared to the FTA and CCDR's APR calculation mechanics: ALRI 1998; Bowes 1999; ALRI 1999.

[106] It might be more precise to say that the first variable–value received by the borrower–is value other than the value of the credit itself. Credit is valuable in itself; that is why anyone pays for it. Measuring the cost of credit can be thought of as separating the value received by the borrower into two components: (1) the value of the credit itself; and (2) the value of everything else received by the consumer in connection with the transaction.

[93] The basic ideas of the TCC and APR can be illustrated by the simple example of a monthly-payment instalment loan in the accompanying box. The TCC is simply the dollar cost of credit: the total value *given* by C less the total value *received* by C from L in connection with the transaction.[107] Since C receives $10,000 and will pay $12,000 over the course of the transaction, the TCC is $2,000.

Consumer (C) borrows $10,000 from Lender (L), and agrees to repay the amount borrowed plus all credit charges in 24 payments of $500 each.

[94] The APR for an actual credit agreement ("loan") can be thought of as the annual interest rate on a hypothetical loan that shares certain crucial characteristics with the actual loan. The shared characteristics relate to the amount and timing of value received ("advances") and value given ("payments") by the borrower. The amount and timing of the advances and payments on the hypothetical loan correspond exactly to the amount and timing of the advances and payments on the actual loan. Thus, in the context of our example, the APR for the actual loan corresponds to the annual interest rate for a hypothetical loan in which the borrower receives a single advance of $10,000 at the outset of the loan and pays off the loan in 24 monthly payments of $500 each. In this discussion we will refer to the complete specification of the amount and timing of each advance and payment to be received or made by the borrower as the loan's "A-P Schedule."

[95] In addition to matching the A-P Schedule for the actual loan, the hypothetical loan will have the following characteristics, which *may or may not* correspond to characteristics of the actual loan.

1. It is an "interest-only" loan; the borrower does not have to pay any charges other than interest in connection with the loan. By "interest" we mean charges that (a) accrue over time and are payable only after they have accrued and (b) are quantified by applying an "interest rate" to the principal outstanding from time to time.

2. The details of how interest is calculated and how payments are applied as between accrued interest and principal are determined by a specific set of

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[107] See CCTA s. 59(2).

rules. The details of the rules are a matter of convention, and different jurisdictions may adopt different conventions, but the convention that applies is determined by law, rather than by the agreement of the parties.[108]

3. The interest rate is fixed and constant for the whole term of the loan.

Assuming that CCDR section 24 applies to the actual loan, the annual interest rate for the hypothetical loan is determined on the basis that accrued interest is never compounded and that payments are applied first to accrued interest and then to principal.[109]

[96] For a hypothetical loan with the A-P Schedule of our preceding example, the periodic (monthly) interest rate can be calculated by solving for i in the following equation:

$$A = P\frac{1-(1+i)^{-n}}{i}$$

where A = $10,000 (the amount advanced); P= $500 (the amount of each payment) and n = 24 (the number of payments). Since i cannot be isolated by itself on one side of the equation, its value must be determined by a trial and error ("iterative") process.[110] The value of i turns out to be about 0.015131. Since i is the monthly rate, the nominal annual interest rate for the hypothetical interest-only loan is 12 times i or about 18.2%. This is the APR for the actual loan.

[97] It is quite possible that the terms of the actual loan correspond in all respects to the characteristics to the hypothetical loan. That is, the actual loan is a constant-rate, interest-only loan, and the contractual method of calculating interest and

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[108] Ideally, in any given jurisdiction, the same convention will apply to all credit agreements. Under the FTA, however, there are three different conventions that might apply. CCDR section 23 is designed to accommodate the method of disclosing interest rates mandated by section 6 of the *Interest Act*. CCDR section 24 applies to credit agreements where the interest rate is not disclosed in the manner contemplated by section 6 of the *Interest Act*, and prescribes a set of rules that result in a nominal annual rate. Finally, section 26, which applies to leases, also prescribes a set of rules that result in a nominal annual rate. However, there are subtle differences between section 24 and 26, so that in certain circumstances a nominal rate calculated in accordance with section 24 would be slightly different than a nominal rate calculated in accordance with section 26.

[109] See CCDR s. 24(4)(d), (e).

[110] The iterative process will normally be handled by a computer or financial calculator and will be transparent to the user. The computer or calculator is programmed to search for a value of i that will bring the value of the right side of the equation very close to the value of the left side.

allocating payments corresponds to the statutory conventions. In such cases, the APR for the actual loan is nothing other than its annual interest rate.

[98] But suppose that the contract for the loan in our example says that L is making C a loan of $11,000 at an interest rate of 8.5%, with a $1000 "service charge" to be deducted from the amount advanced to C. Under the FTA, the amount advanced that is considered to be advanced to the borrower does not include the $1000 service charge,[111] so the APR is calculated using exactly the same numbers that were used to calculate the annual interest rate for the hypothetical interest-only loan. That is, the loan is treated as a $10,000 loan to be repaid in 24 monthly payments of $500 each. The APR of 18.2% is much higher than the stated contractual interest rate of 8.5%.

b. When Must TCC and APR be Disclosed

[99] The TCC and APR must be disclosed for all fixed credit agreements[112] and leases.[113] An advertisement that offers fixed credit and states the interest rate or the amount of any payment must disclose the APR.[114] Advertisements for fixed credit must also disclose the TCC under certain circumstances.[115] An advertisement that gives "any specific information about the cost of a lease" must disclose the APR for the lease.[116]

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[111] FTA s. 59(3), (4). The service charge does not come under any of the heads of "value received" set out in section 59(3). Section 59(4)(b) preempts any possible argument that the service charge can be treated as an advance because it is for services provided by the credit grantor to the borrower in connection with the loan.

[112] FTA ss 74, 77; CCDR s. 8(1)(n), (o).

[113] FTA s. 93; CCDR s. 19(1)(n), (o). In the context of leases the CCDR replaces the term "total cost of credit" with "implicit finance charge:" see CCDR s. 17(1)(d).

[114] FTA s. 76(1); CCDR s. 6(2)(a).

[115] CCDR s. 6(3)(b).

[116] FTA s. 92; CCDR s. 18(1)(f).

[100] The TCC does not have to be disclosed for open credit, but the APR must be disclosed in advertisements[117] and the initial disclosure statement[118] (but not periodic statements) for open credit that is not associated with a credit card. Thus, a lender who offers a line of credit that is not associated with a credit card must disclose an APR in the initial disclosure statement.

c. *Basic Calculation Issues*

[101] Much of the complexity of ccdl arises from the necessity to calculate such secondary data as the TCC and APR, particularly the latter. To a certain extent, careful legislative drafting can make life easier for those who must use and interpret such legislation. But all that the most skilfully and carefully drafted statute can do is avoid compounding inevitable complexity with unnecessary ambiguity. Complexity, and even a certain measure of ambiguity, is inevitable in any statute that requires credit grantors to calculate and disclose an APR.[119] This section briefly describes some of the sources of complexity in cost of credit calculations.

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[117] FTA s. 83(1); CCDR s. 12(1).

[118] CCDR s. 13(1)(g).

[119] One problem faced by the drafter of ccdl is that an attempt to avoid ambiguity by addressing all possible contingencies inevitably increases the length and complexity of the statute. For example, the FTA, like other North American ccdl, ignores the fact that in certain circumstances there may be multiple solutions to the equations or algorithms that are used to calculate the APR. The point is put thus in the owner's manual for a financial calculator:

> The HP-19B calculates IRR% [the APR is analogous to the internal rate of return] for a set of cash flows using mathematical equations that "search" for the answer. The process finds a solution by estimating an answer and then using that estimate to do another calculation–in mathematical terms, an iterative process.
>
> In most cases, the HP-19B finds the unique IRR% if it exists. However, calculating IRR% for certain sets of cash flows is more complex. There may be more than one mathematical solution to the problem, or there may be no solution.
>
> –Hewlett Packard 1992 at 285

The drafter of regulations under the UK *Consumer Credit Act 1984* provided for this mathematical possibility by means of the following provision:

> In a case where more than one rate per annum is given under the foregoing provisions of this regulation, the annual percentage rate of charge determined under this regulation is the positive rate per annum nearest to zero or, if no positive rate is so given, the negative rate nearest to zero.
>
> –Consumer Credit (Total Charge for Credit) Regulations 1980 SI 1980/51, s. 9(3).

The CCDR, in common with all North American ccdl, ignores the possibility that in certain circumstances there could be multiple solutions to the APR calculation formulas. In practice, it is unlikely that the A-P schedule for a consumer credit agreement for which an APR must be calculated will create the possibility of multiple solutions to the APR calculation algorithm.

i. Identification of Component Charges

[102] Some of the complexity of cost of credit calculations–especially APR calculations–is mathematical.[120] However, much of the complexity has nothing to do with mathematics. Rather, it reflects the tensions between the theoretical objectives of cost of credit disclosure and the exigencies of the real world in which the cost of credit must be disclosed and disclosure legislation drafted. These tensions reveal themselves particularly in the context of identifying the charges that must be included in the cost of credit.

[103] We said earlier that, *in theory*, both the TCC and APR measure the total cost to the consumer of the privilege of getting some form of credit: the use of money or the use of goods or services before they are paid for in full. They both measure the cost of credit by comparing the value *received* by the consumer in connection with a credit transaction with the value *given* by the consumer in connection with the transaction.

[104] In some cases, it may be a simple matter to identify and quantify value received and given by a consumer in connection with a credit transaction. But it will not always be easy. Consider, for example, a situation where a consumer purchases goods on credit terms. Obviously, the value of the goods constitutes value received by the borrower for the purpose of calculating the cost of credit. But how is the value of the goods to be determined? One possible answer would be that the value of the goods is the value assigned to them by the contract between the parties to the particular contract. But legislators have long since determined that this approach would give sellers too much opportunity to "fudge" the value of the goods for the purpose of calculating the cost of credit. The approach that has long been taken by ccdl to establishing the value received by a consumer on a credit sale is to explicitly tie the value of the goods or services to what a cash customer would pay for them.[121] This approach is continued by the FTA.[122]

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[120] From a mathematical perspective, calculating the TCC is simplicity itself. It involves nothing more than addition and subtraction.

[121] See e.g. CCTA s. 1(d).

[122] FTA ss 58(h) (credit sales), 58(i) (leases).

[105] The principle that the price that cash customers pay for a product establishes its value for cost of credit calculation purposes has implications for certain marketing practices. One such practice is to offer consumers a choice between a cash rebate and low-rate financing. Consumers who choose the low-rate financing must forego the cash rebate. However, since cash customers would get the rebate, for the purpose of calculating the cost of credit the rebate must be deducted when determining the value received by credit customers who choose the low rate option.[123] The effect of deducting the rebate when determining the value received by the consumer is to increase the TCC and APR.

[106] Canadian ccdl follows the theoretical perspective quite closely on the issue of quantifying the value received by a consumer who purchases a product on credit terms. But it drifts away from the theoretical perspective on some other issues. Some non-interest elements of the cost of credit, as viewed from the theoretical perspective, are excluded from the legislative definition of the cost of credit. Some of the omissions represent inevitable concessions to the uncertainties of the real world in which the legislative APR must be calculated. Other omissions are more accurately explained as the result of "political realities."

[107] It is unnecessary to descend very far from the realm of theory into the arena of reality to encounter difficulties in deciding whether a certain charge, or some portion of a charge, should or should not be treated as part of the cost of credit. For example, it is a common practice for lenders who extend credit on the security of expensive property, such as a home, to require the borrower to insure the property against fire and other perils. The FTA provides, in effect, that a premium for casualty insurance on the subject matter of a security interest is not treated as part of the cost of credit so long as the borrower is a beneficiary and the insured

[123] This would seem to have been the case under CCTA s. 1(d), which stated that the cash price had to reflect "any reduction . . . given by the seller of the goods or services if the goods or services are paid for in full" at the time of purchase. For a case interpreting somewhat similar wording in Ontario, see *Re Motor Vehicle Manufacturers' Association and Wrye* (1988), 49 D.L.R. (4th) 592 (Ont. H C.). CCDR s. 25 makes it even clearer that where a consumer must forego a rebate to enter into a credit sale at a particular interest rate, the foregone rebate must be deducted when determining the value received by the borrower for cost of credit calculation purposes. The challenge that rebate-or-low-rate financing programs present to ccdl is discussed in Bowes 1991 at 208-1; ALRI 1993. See Dobson 1996 for a discussion of the same issue in the context of the U.K. *Consumer Credit Act 1974*.

amount is the full insurable value of the subject matter.[124] Is this exclusion appropriate from the perspective of the theoretical function of the APR and TCC?

[108] On the one hand, the premium for the insurance is a charge that the borrower must incur in order to obtain credit. Thus, it would appear to come within the theoretical definition of the total cost of credit. On the other hand, the casualty insurance coverage is presumably of some independent value to the consumer. Indeed, most consumers would insure their home against fire and other perils whether they were required to do so as a condition of entering into a credit agreement or not. Therefore, even a conceptual purist might concede that it is reasonable to exclude premiums for casualty insurance from the cost of credit, even if the credit grantor requires the borrower to obtain such insurance.

[109] From the theoretical perspective, it is more difficult to justify the exclusion of other costs that typically are excluded from the cost of credit in ccdl. Charges for registration of security interests or conducting searches of the relevant registries are almost always excluded from the cost of credit for APR-calculation purposes.[125] Similarly, the legislative APR typically excludes premiums for "mortgage insurance," insurance that protects the lender–not the borrower–against the risk of default.[126]

[110] Legislative ambivalence about the APR seems to be a major source of complexity in definitions of the components of the cost of credit. On the one hand, legislators have determined that credit grantors should be required to disclose the

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[124] FTA ss 59(3)(f)(iv), (5)(b)(i). Section 59(3)(f)(iv) treats the amount of the premium as value received by the borrower where it is paid in the first instance by the credit grantor who then charges it back to the borrower. Section 59(5)(b)(i) deals with the more likely scenario where the credit grantor requires the borrower to purchase casualty insurance. In certain circumstances, payments that a borrower makes to third parties for services that the credit grantor requires the borrower to purchase will be treated as "payments" when calculating the cost of credit. However, when section 59(5)(b)(i) applies, the amount paid to the third party will not be treated as a "payment" for cost of credit calculation purposes.

[125] See FTA s. 59(3)(f)(i). The effect of treating a charge for registering a security interest as "value received by the borrower" is that there is an advance that offsets the payment the borrower will make in respect of the charge, so the APR will be the same as it would have been if there had been no charge and no payment. This applies whether the charge is paid up-front by the borrower or is capitalized and paid over the term of the credit agreement.

[126] See FTA s. 59(3)(f)(iii). The effect of excluding the premium for mortgage insurance from the cost of credit is to understate the APR for an insured loan relative to the APR for an uninsured loan.

cost of credit as an APR. On the other hand, for various reasons, legislators have also decided that certain charges that in theory form part of the cost of credit should be excluded from the legislative APR. The need to define the cost of credit in a manner that excludes such charges accounts for much of the definitional complexity of ccdl.

ii. Calculation Mechanics

[111] In addition to complexity in defining the components of the cost of credit, mandatory APR disclosure entails a certain amount of mathematical complexity. It is unnecessary to have a degree in higher mathematics to understand the mathematical principles involved in the concept of the APR or the method of calculating it. On the other hand, the mathematical concepts involved in APR calculations are somewhat more complicated than the average lawyer or business person will be called upon to deal with on a regular basis. Thus, the mathematics of APR calculations may appear daunting to many of those who must interpret and apply ccdl.

[112] Expressing the mathematical concepts needed for APR calculations in a statute presents challenges to the legislative drafter that would not be faced by the author of a textbook on financial mathematics. The author of a textbook who wants to explain how to calculate the internal rate of return[127] may at least assume that readers want to learn how to solve internal rate of return problems. In contrast, the legislative drafter cannot be as sanguine about the objectives of those who will be reading the legislative text. The legislative drafter must keep at least one eye out for readers whose objective will be to do their utmost to find a way to interpret the legislation in a manner that the drafter did not intend. The necessity of dealing with this sort of reader complicates the legislative drafter's task and adds to the complexity of legislation that requires APR disclosure.

[113] We will return to some of the conundrums entailed by mandatory APR disclosure in the context of the debate that occurred during the harmonization process as to whether mandatory APR disclosure should be retained. Before doing so, however, we continue our overview of FTA Part 9 by considering its major substantive provisions.

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[127] The APR is the legislative equivalent of the internal rate of return on a series of cash flows: see note 119 above.

5. Miscellaneous Substantive Provisions

[114] When we refer to "substantive" provisions, we mean legislative provisions that limit what the parties to a contract may agree to or that apply certain rules to a contractual relationship regardless of what the parties have agreed to. Such provisions may be distinguished from disclosure provisions, which do not restrict what the parties to a contract may agree to, but simply require disclosure of the consequences of what has been agreed to. Statutes concerned primarily with disclosure of the cost of credit have traditionally included some substantive provisions. FTA Part 9 carries on this tradition. The major substantive provisions of FTA Part 9 are described briefly below.

a. Prepayment Rights

[115] The FTA follows in the footsteps of the CCDA in providing consumers with a right to prepay non-mortgage credit agreements at any time without any prepayment charge or penalty.[128] Like the former Act, the FTA provides a mechanism whereby the consumer who prepays the outstanding balance on a credit agreement will receive a rebate of any non-interest finance charge ("NIFC"). The mechanism for calculating the rebate is, however, different under the FTA than it was under the CCTA.[129]

[116] There is no case law interpreting the prepayment provisions of the CCTA. And it seems like a fair bet that the mechanics of prepayment calculations under the CCTA were not widely understood. However, the relevant provisions of the Act[130] indicate that the outstanding balance at the time of the prepayment would be calculated on the assumption that the credit charges were distributed in an actuarial manner over the term of the loan. In other words, the amount outstanding would be calculated by assuming (1) that the original principal balance did not include any credit charges that, according to the contract, were added to the principal balance; and (2) that the amount outstanding at the time of prepayment was determined by treating the APR as an interest rate. One implication of this was that if the

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[128] FTA s. 68(1), (2). The wording of FTA s. 68(2) is very similar to the wording of CCTA s. 27(3).

[129] In fact, the CCTA did not talk about a rebate of credit charges. Instead, the rebate of lump-sum credit charges was implicit in the CCTA's directions as to how credit charges were to be calculated and how payments were to be applied: CCTA ss 9, 10.

[130] CCTA ss 9,10, 27(2).

borrower prepaid the loan, the actual APR (that is, the APR based on the actual amount and timing of the borrower's payments, including the prepayment) would be the same as the APR disclosed to the borrower at the beginning of the loan.[131]

[117] As mentioned, the FTA (actually, the CCDR) takes a different approach to calculating the portion of any NIFC that is to be rebated to the borrower who prepays a loan.[132] The CCDR eschews an actuarial calculation based on the APR. Instead, it adopts a method that, whatever else may be said about it, is quite simple. In essence, the CCDR assumes that, in the first instance, the balance outstanding at the time of prepayment is calculated in the manner contemplated by the contract. Having calculated that balance, the borrower must then be credited with the "unearned" portion of the NIFC. The amount of the NIFC that is considered to be unearned at the time of prepayment is directly proportional to the amount of time remaining in the term. If prepayment occurs after 1/3 of the term has expired, 2/3 of the NIFC must be refunded. If it occurs when 2/3 of the term has expired, 1/3 of the NIFC must be refunded.

[118] It is interesting to note that the FTA's method of calculating the prepayment refund is more generous to the borrower than the actuarial method that was implicit in the CCTA. Under the actuarial method, the greatest proportion of a NIFC would be assumed to be earned in the early part of the term, when the outstanding principal balance is higher. But the FTA method assumes that the NIFC is evenly distributed over the term. Therefore, at any given point during the term the FTA method will assume that a greater proportion of the NIFC is unearned (and hence refundable) than will the actuarial method. This means that under the FTA, the actual APR for the borrower who prepays a loan with a refundable NIFC will be somewhat *lower* than the disclosed APR.

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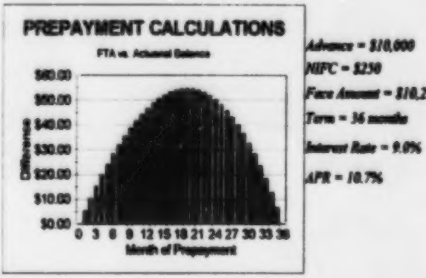
131 This contrasts with the result in a "pure disclosure" environment, in which credit grantors who imposed a NIFC at the beginning of a loan were required to account for the charge in the disclosed APR but were not required to refund any portion of the charge if the borrower prepaid the loan. In this case, if the borrower prepaid the loan the actual APR would be higher than the disclosed APR. The earlier in the term the borrower prepaid the loan, the higher would be the actual APR.

132 FTA s. 68(3); CCDR s. 28. A borrower who prepays a portion, rather than the whole, of the outstanding balance is not entitled to a refund of or credit for NIFCs: FTA s. 68(5).

[119] The preceding point is illustrated by the following chart. It assumes that a $250 NIFC is added to the initial balance of loan under which the borrower actually receives $10,000. For APR calculation purposes the borrower receives an advance of $10,000, but the face amount of the loan is $10,250. The contractual interest rate is 9.0%, the term is 36 months, and the APR is 10.7%. The chart shows the difference between the total amount the borrower will have to pay under the two prepayment calculation methods–actuarial (CCTA) and FTA–at various points in the term. For example, a borrower who pays the outstanding balance after 12 months will be a little less than $50 better off under the FTA calculation method than they would have been under the actuarial method.



b. Cancellation of Optional Services

[120] Although the CCTA allowed for prepayment of non-mortgage loans, it made no specific provision for cancellation of optional services provided in connection with a credit agreement. The FTA does.

[121] An optional service under the FTA is a service that is offered to the borrower in connection with a credit agreement that the borrower does not have to accept in order to enter into the credit agreement.[133] Optional life insurance is an obvious example of an optional service. Other examples include delivery or installation of goods purchased under a credit sale or a service contract or extended warranty for such goods.

[122] An optional service might actually be provided by an unrelated third party, rather than the credit grantor. However, the FTA's cancellation right only applies where the optional service is provided by the credit grantor or an "associate"[134] of

[133] FTA s. 58(aa).

[134] The term "associate" is defined in CCDR s. 1(1).

the credit grantor.[135] It also only applies where the service is of a "continuing nature."[136] Here a contrast may be drawn between one-time services such as delivery or installation of goods purchased under a credit sale and continuing services such as insurance, a service contract or an extended warranty.

[123] The right to cancel the optional service is not tied to prepayment of the relevant credit agreement. The consumer who cancels an optional service is entitled to a credit for any portion of the service that has not been provided at the time of cancellation. Although the FTA provides for regulations that would prescribe the method of calculating the prepayment refund, no regulations on this subject have yet been made.[137]

c. *Default Charges*

[124] The FTA limits the "default charges" that may be imposed on a consumer who fails to make a payment when it comes due or fails to comply with any other obligation under a credit agreement.[138] A credit agreement may only provide for default charges that fall within one of the three categories set out in FTA section 69: (a) legal costs incurred in attempting to collect a payment; (b) costs incurred to realize a security interest or protect the subject-matter of a security interest after default; (c) charges incurred because a cheque or other payment instrument given by the borrower to the credit grantor is dishonoured. In all cases the relevant charge must be "reasonable."[139]

[125] The definition of "default charge" in FTA section 58 *excludes* interest on an overdue payment. Therefore, the restriction on default charges in FTA section 69 does not prevent a credit agreement from providing for compound interest on an overdue payment, nor would it prevent a credit grantor from charging a higher rate

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[135] FTA s. 67(1).

[136] *Ibid.* An example of an optional service that is not of a continuing nature might be delivery or installation of goods purchased under a credit sale.

[137] And it is our understanding that there is no immediate plan to make such regulations.

[138] FTA ss 58(o), 69.

[139] CCDR s. 1(4) provides that reasonable charges for legal costs include solicitor and client costs.

of interest on overdue payments.[140] The restrictions on default charges apply only to lump-sum charges.

d. Unauthorized Charges on Lost or Stolen Credit Cards

[126] The FTA's approach to lost or stolen credit cards is similar to that of the CCTA.[141] A consumer has no liability for debts incurred through the use of a lost or stolen credit card once the card issuer has been informed of the loss or theft.[142] The borrower's maximum liability for debts incurred before the card issuer receives notice of the loss or theft is $50.[143] Under the CCTA the $50 limitation applied only if the card holder gave notice of the loss or theft within a reasonable time after learning of it. This qualification was not carried forward into the FTA.

[127] The FTA's limitation on card holder liability does not apply to the use of a credit card in conjunction with a personal identification number at an automated teller machine.[144] Another qualification on the limitation of liability provided by FTA section 89(3) arises out of the general limitation on the scope of Part 9. It will be recalled that Part 9 applies only if the borrower is an individual who enters into the credit agreement primarily for personal, family, household or farming purposes.[140] Thus, the limitation on card holder liability for unauthorized use of a lost or stolen card would not appear to apply to a "corporate" credit card.

e. Residual Obligation Leases

[128] FTA Part 9 uses the term "residual obligation lease" ("RO lease") to refer to a type of lease that is sometimes referred to as a financing lease or an open-end

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140 But section 8 of the *Interest Act* (Canada) restricts the ability of a lender to charge a higher rate of interest "on any arrears of principal or interest secured by mortgage on real property."

141 See CCTA s. 30.

142 FTA s. 89(1).

143 FTA s. 89(3). Actually, it is the lesser of $50 and the amount specified in the credit card agreement, but it seems highly unlikely that the latter will be less than the former.

144 FTA s. 89(4); CCDR s. 16.

140 See section C.1.a above.

lease.[141] To explain the concept of an RO lease, it is useful to consider a couple of assumptions that underlie an ordinary lease.

[129] Suppose that a consumer leases a car worth $20,000 for three years under an ordinary lease.[142] Given normal usage, the lessor estimates that it will be able to dispose of the car for $10,000 at the end of the term. The level of the lease payments will be determined on the basis of the lessor's expectation that it will receive an asset worth $10,000 at the end of the term. The expected proceeds of disposition at the end of the lease term could be referred to as the "*estimated residual value*" of the leased goods.[143] Under the ordinary lease the lessor assumes the risk of greater than expected depreciation of the leased goods (at least insofar as the depreciation is due to causes beyond the control of the lessee). Since the risk of any difference in the estimated and actual residual value of the leased goods is borne by the lessor, the consumer need not be particularly concerned with how the estimated residual value of the leased goods is determined.

[130] In an *unregulated* environment the lessee under an RO lease has a much greater stake in knowing how the residual value of the leased goods, as *stated* in the lease, has been determined. This is because in an unregulated environment the lessee under an RO lease is liable for any difference between the stated residual value of the leased goods and their actual realizable value at that time. If the *stated* residual value is actually their *estimated* residual value (as defined in the preceding paragraph), the RO lease is simply transferring the risk of greater than expected depreciation from the lessor to the lessee. Presumably, a fully informed consumer might agree to accept this risk in return for lower lease payments than would be required under an ordinary lease.

[131] What happens, however, if the stated residual value of the goods leased under an RO lease exceeds their estimated residual value? What happens, in other

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[141] The latter term is used in U.S. legislation: see e.g. 12 CFR §213(i).

[142] By an "ordinary lease" we mean a lease in which the consumer's only obligation at the end of the lease term is to return the leased goods to the lessor in the condition specified by the lease. Of course, the lessee might have contingent obligations to pay for damage to the goods going beyond normal wear and tear or to pay a specified amount for excess use of the goods.

[143] See FTA s. 90(a), where "estimated residual value" is defined as the lessor's reasonable estimate of the goods' wholesale value at the end of the lease term.

words, if the residual value as stated in the lease is not really a genuine estimate of the end-of-term realizable value of the leased goods, but is some higher amount? The short answer is that, given normal depreciation, the goods will be worth less than the stated residual value, and the lessee will be liable for the difference. Another way of putting it is that in the ordinary course of events, the lessee will be liable to make a *residual cash payment* at the end of the lease.

[132] There is nothing inherently wrong or unfair about a lessor and a fully informed lessee agreeing to a lease in which the lessee will be liable in the ordinary course of events to make a residual cash payment. In effect, the lessee would be agreeing to make a cash payment at the end of the term in return for lower payments during the term. The real problem, as it has been perceived by legislators, is one of asymmetrical information. Consumer lessees will not generally be in a position to evaluate whether the stated residual value is a genuine and reasonable estimate of the actual residual value of the leased goods. Therefore, in an unregulated environment RO leases present a real danger that consumers will incur end-of-term obligations whose magnitude they did not really appreciate when they entered into the lease.

[133] The legislative approach to this problem has focussed on ensuring that the stated residual value really is a reasonable estimate of the actual term-end value of the leased goods. Since 1974 the U.S. TILA has contained provisions relating to consumer leasing. One of these provisions[144] is to the following effect:

- the stated residual value[145] in an RO lease must be "a reasonable approximation of the anticipated actual fair market value of the property on lease expiration;"
- there is a rebuttable presumption that the stated residual value is unreasonable and not made in good faith to the extent that it exceeds the actual residual value by more than three times the average monthly payment;
- where the stated residual value does exceed the "three-months' payments" boundary, the excess can only be recovered by action, and in any such action the lessor is responsible for paying the lessee's reasonable attorney fees;

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[144] 15 USC §1667b(a).

[145] The section uses the term "estimated residual value" but it uses it in the sense that we have been using the terms "stated residual value."

- the rebuttable presumptions do not apply to the extent the excess is due to physical damage going beyond reasonable wear and tear or to excess use.

In effect, three months' lease payments represents the ceiling (apart from the damage or excess use exception) on the lessee's residual liability under an RO lease. In theory, it is only a presumptive ceiling, but the requirement for the lessor to pay the lessee's reasonable attorney fees in any action to recover the excess must come very close to making it an absolute ceiling.

[134] In 1991 Quebec amended its *Consumer Protection Act* to include provisions relating to consumer leasing. These provisions provide similar protection with respect to RO leases to that provided by the U.S. provisions. The stated residual value must be based on "a reasonable estimation by the merchant of the wholesale value which the goods will have at the end of the leasing period."[146] The consumer's maximum liability at the end of the term is limited to 20% of the stated residual value.[147] Unlike the U.S. legislation, the Quebec provision creates an absolute rather than a presumptive ceiling. As noted above, however, the U.S. presumptive ceiling is very close to being an absolute ceiling (damage or excess use aside).

[135] In 1994 British Columbia made regulations under its *Motor Dealer Act* that create disclosure requirements in the context of consumer motor vehicle leases.[148] They also deal with RO leases. The British Columbia approach is to impose an absolute ceiling (subject to a "normal wear and use" qualification) on the lessee's residual obligation. The ceiling is "3 average monthly payments under the lease."[149]

[136] Now we come to the FTA's approach to RO leases, which of course is based on the Harmonization Agreement. We noted earlier that the basis for legislators' discomfort with RO leases in an unregulated environment relates to the potential for consumers to incur an unexpected residual liability because they cannot readily

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[146] *Consumer Protection Act*, R.S.Q., c. P-40.1, as am. by S.Q. 1991, c. 24, s. 150.19.

[147] *Ibid.* s. 150.21.

[148] *Motor Dealer Leasing Regulation* B.C. Reg. 391/94.

[149] B.C. Reg. 391/94, s. 3(c).

determine whether the stated residual value is realistic. There is, on the other hand, no inherent objection to a consumer agreeing to make a residual cash payment for a known amount. With this in mind, the FTA distinguishes between two things: (1) the estimated residual cash payment[150] and (2) the contingent payment that the lessee may be required to make if the realizable value of the leased goods is less than their estimated residual value.

[137] The estimated residual cash payment for an RO lease is an amount that the lessee will be required to pay if the actual residual value is the same as the estimated residual value.[151] The FTA places no restriction on the amount of the estimated residual cash payment. But the FTA does restrict the contingent payment. The method by which it does so reflects the dynamics of the harmonization process. The maximum amount of the contingent payment is the lesser of three amounts:

- the estimated residual value less the net proceeds for which the lessor disposes of the goods;
- 20% of the estimated residual value (the Quebec approach);
- three months' payments (the B.C. approach).[152]

The lessee's maximum term-end liability on an RO lease is the sum of the estimated residual cash payment and the contingent payment. This is subject to the usual "excess wear or use" exception.[153]

[138] To illustrate the foregoing, suppose that the disclosure statement for a lease contains the following information:

- the estimated residual value is $10,000;
- the estimated residual cash payment is $1000;
- the monthly payments are $500.

At the end of the term the goods are disposed of for net proceeds of $8,000. In this case, the difference between the estimated residual value and the actual proceeds of disposition is $2,000, which happens to be 20% of the estimated residual value.

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[150] CCDR s. 17(1)(b).

[151] *Ibid.*

[152] CCDR s. 29(1), (2).

[153] CCDR s. 29(3).

However, three months lease payments total $1,500, so the lessee's contingent payment is limited to $1,500. The total residual obligation is $2,500: the estimated residual cash payment of $1,000 plus the contingent payment of $1,500.

6. Compliance Provisions

[139] Under the CCTA, a credit grantor who failed to make disclosures in accordance with the act was at risk of losing all credit charges for the relevant credit agreement.[154] In the event of such non-compliance, the credit grantor could only recover "an amount, if any, in respect of the credit charges that a court, having regard to the intent of this Act, considers appropriate in the circumstances."[155] However, by virtue of the regulations under the CCTA, section 8 did not apply to mortgage loans.[156] Therefore, apart from the remote possibility of a prosecution under the CCTA's penal provisions, a mortgage lender would suffer no consequences if it failed to comply with the CCTA's disclosure requirements, while other credit grantors might lose all of their credit charges.

[140] Division 6 of FTA Part 9 is headed "Compliance"but deals only with the civil consequences of non-compliance with Part 9.[157] In contrast to the CCTA, FTA Part 9 does not purport to deprive a credit grantor of all or any portion of the cost of credit because of non-compliance with disclosure requirements. Instead, in addition to certain compensatory remedies, the FTA provides two civil remedies that are designed to provide credit grantors with significant incentives to comply with the Act.

[141] Section 98(2) of the FTA provides that a credit grantor who contravenes the Act is subject to an action for statutory damages. The statutory damages are the *lesser* of $500 and 5% of the amount advanced under the credit agreement (or the credit limit, in the case of open credit). However, the credit grantor is not liable for

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[154] CCTA s. 8.

[155] CCTA s. 8(c).

[156] Consumer Credit Transaction Regulation, s. 3.1(2).

[157] Division 6 constitutes an exception to the rule that FTA Part 9 implements policies agreed to in the Harmonization Agreement. The Harmonization Agreement does not deal with enforcement. Division 6 is based on Part 6 of the ULCC's CCDA. So the policy choices embedded in Division 6 reflect the ALRI-ULCC approach to this subject.

statutory damages if the contravention is an "excusable error," which is defined in section 98(1). Essentially, a contravention is an excusable error if it occurred notwithstanding diligent efforts by the credit grantor to comply with its disclosure obligations under FTA Part 9.[158]

[142] The prospect of incurring statutory damages of $500 per transaction might not seem to provide credit grantors with a huge incentive to comply with their disclosure obligations. It is important, however, to keep in mind the relatively modest cost of compliance efforts. A credit grantor's cost per transaction of diligent efforts to comply with its disclosure obligations will be a small fraction of the maximum statutory damages. The prospect of incurring statutory damages of $500 in respect of each of a large number of transactions is more significant when compared to the relatively modest cost of compliance efforts.

[143] The statutory damages provided for by section 98 are intended to prevent credit grantors from being lazy with respect to their disclosure obligations under Part 9. The possibility exists that some credit grantors might be tempted to deliberately ignore their obligations under Part 9 with a view to misleading borrowers. For this type of deliberate contravention, Part 9 provides a more robust remedy than the modest statutory damages. Section 99 authorizes the court to grant exemplary damages in the case of deliberate contravention or other conduct that justifies the awarding of exemplary damages.

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[158] See the definition of "compliance procedure" in FTA s. 95(2).

D. The Great APR Debate

[144] Both proponents and opponents saw mandatory disclosure of the APR as the major innovation and key element of the legislation proposed, and eventually enacted, during the truth-in-lending wave of the sixties and seventies. That this perception lives on is illustrated by a press release issued in 1996 following a meeting of federal, provincial and territorial ministers of consumer affairs in connection with the harmonization process under the AIT:

> Ministers agreed in principle to standard disclosure on all forms of consumer credit, including for the first time, in most jurisdictions, long term leasing. . . A main feature of the proposals is the use of a single method for representing the cost of credit. This method–the Annual Percentage Rate–will allow consumers to readily compare the cost of various credit alternatives, such as leasing versus loans, or other types of supplier credit. This means that consumers will be better informed and able to compare credit costs.

The press release illustrates the esteem in which mandatory APR disclosure continues to be held by those who determine cost of credit disclosure policy.

[145] We have already noted that from 1992 through 1995, ALRI-ULCC were developing an approach to cost of credit disclosure that would *not* have required credit grantors to calculate and disclose an APR for most credit agreements. This section briefly describes the major reasons why ALRI-ULCC were proposing to abandon APR disclosure (in most instances) and what we were proposing in its place.[159] Sections 1 through 4 briefly describe some of the drawbacks of mandatory APR disclosure as seen by ALRI-ULCC. Section 5 briefly describes the approach we were proposing as an alternative.

1. Ambiguity of APR Signal for Unsophisticated Users

[146] One of the purported virtues of mandatory APR disclosure is that the APR can be used to compare the cost of differently configured credit arrangements: loans for different amounts, for different terms or with different payment schedules. It is true that the APR can be used for this purpose. However, directing unsophisticated consumers to compare the APRs of different possible credit arrangements and to choose the arrangement with the lowest APR would not necessarily point them in the right direction.

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[159] This subject is discussed in more detail in ALRI 1995 (1); Bowes 1997.

[147] To illustrate the foregoing point, suppose that a consumer wants to borrow $5000 and has the choice of two loans, which are identical in all respects except that the first would be for a term of *one year*, the second, for *three years*. In each case, the nominal annual interest rate would be 12%. A $200 administration fee would be deducted from the amount advanced to the borrower, who would thus actually receive $4,800.[160] The monthly payments on the one-year and three-year loans would be about $444 and $166, respectively.

[148] All else being equal, a given lump sum charge will have a greater impact on the APR for a loan with a shorter term than a loan with a longer term.[161] In this case, the effect of the $200 fee manifests itself in APRs for the one-year and three-year loans of 19.8% and 14.9%, respectively. Suppose that borrowers are told that a loan with a lower APR is cheaper than a loan with a higher APR. On this basis, the three-year loan would clearly be the loan of choice. On the other hand, most personal financial counsellors would probably say that consumers who must borrow should generally pay off loans as quickly as their budget allows. On this theory, the borrower would be better off with the one-year loan, although its APR is higher.

[149] The foregoing example is not meant to suggest that the APR is in some way invalid as a measure of the cost of credit. It is meant to illustrate that, even when talking about an ideal APR, a comparison of APRs for different loans does not provide an unerring pointer to the most cost-effective solution to an unsophisticated borrower's credit needs. To make effective use of the APR as a tool for analysing the relative cost of different credit arrangements, a consumer needs a certain amount of background information about the use and misuse of the tool. The problem is that it is highly unlikely that such background information will be packaged with the APR information provided under a mandatory disclosure regime.

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[160] The numbers in the text assume that the face value of the loan is $5,000 and the borrower actually receives $4,800.

[161] It will also have a greater effect on a smaller loan than on a larger loan.

2. Difficulty or Impossibility of Timely APR Disclosure in Certain Contexts

[150] In theory, the primary virtue of the APR is that it provides a time-rate measure of the total cost of credit that takes account of non-interest charges as well as interest. It does so by making use of mathematical formulas or algorithms whose raw data are the amount and the timing of each advance and payment to be made in connection with a credit arrangement. Unfortunately, in the real world of consumer credit some of the raw data necessary to calculate an APR for a credit agreement often will be unknown at the time that knowledge of the APR might be useful in making a credit-purchasing decision.

[151] Open credit, as exemplified by a line of credit, provides the best example of where it is impossible to prospectively calculate the actual APR for a credit agreement involving non-interest charges. For example, suppose that a consumer obtains a $10,000 line of credit for which there is a $100 annual fee, payable at the beginning of each year. Without bothering to do any fancy calculations, it is readily apparent that if the average principal outstanding over the course of a year is about $5,000, the effect of the $100 fee will be to increase the APR by about 2%. If, however, the consumer's entire use of the line of credit during the year consists of borrowing $1000 for one month, the $100 fee would increase the nominal APR by about 120%.

[152] Since the effect of the $100 fee on the APR depends on how the consumer actually uses the line of credit, a credit grantor could not disclose the actual APR for the line of credit at its outset. At best, the credit grantor could disclose a "presumptive APR," based on certain more or less arbitrary assumptions about how the consumer will use the open credit facility. Although the use of assumptions will allow a credit grantor to disclose *an* APR (not *the* APR) for any prospective credit arrangement, the utility of this APR in the consumer's decision-making process is doubtful.

[153] Although the problem of uncertainty as to the amount and timing of advances and payments is most pronounced in the case of open credit, it may arise in other contexts as well. If a borrower obtains a demand loan and pays certain non-interest charges that are to be accounted for in the APR, the uncertainty as to when the loan will be paid off creates essentially the same sort of problem that exists with respect to open credit.

[154] Another situation where APR calculation may be problematic is in advertisements. If consumers who purchase advertised goods on credit terms will have to pay a $25 administrative charge, the effect of the administrative charge on the APR will depend on the cash price of the particular item that the borrower purchases, the amount of the down payment, if any, and the term over which the balance of the purchase price is to be paid. There is no doubt that an advertiser who is allowed to make assumptions can calculate and disclose a presumptive APR. Again, however, the value of such a presumptive APR to a credit-shopping consumer is questionable.

3. Components of Cost of Credit Excluded from Legislated APR

[155] We noted earlier that there may well be a difference between the theoretical APR for a credit agreement and the APR as calculated in accordance with ccdl. This is because some charges that would form part of the theoretical cost of credit and theoretical APR may be excluded from the legislatively defined cost of credit and APR. As already noted, some of the exclusions are necessary concessions to the uncertainties of the real world in which the legislative APR must be calculated. Others (e.g. the exclusion of mortgage insurance) reflect concessions to political realities. Whatever the reasons for their exclusion, the APR's value as a one-stop measure of the relative cost of different credit arrangements is reduced when it does not account for charges that do in fact affect the relative cost of different credit arrangements.

4. Complexity of Mandatory APR Disclosure

[156] There is no doubt that APR disclosure adds complexity to ccdl. Some of the complexity arises from the fact that mandatory APR disclosure entails the expression of fairly complex mathematical procedures in a legislative framework. As discussed earlier, although the mathematics involved in APR disclosure is only of moderate complexity, the legislative drafter faces challenges that are not necessarily faced by the writer of a mathematical treatise.

[157] Legislative ambivalence about the APR also accounts for some of the complexity. As already discussed, a theoretically pure approach to defining the components of the cost of credit raises will raise some difficult questions of

application.[162] Drawing distinctions between charges that are really in the same theoretical boat cannot help but exacerbate the difficulties.

5. The ALRI-ULCC Alternative to Mandatory APR Disclosure

[158] We noted earlier that ALRI-ULCC initially assumed that mandatory APR disclosure would continue to be a central feature of Canadian ccdl. However, because of the sort of considerations described above, we came to doubt that requiring credit grantors to disclose APRs to consumers was necessarily the optimal method of providing consumers with cost information that would assist them in making rational credit-purchasing decisions. In view of these considerations, we suggested a different approach.

[159] The approach proposed by ALRI-ULCC would not have required credit grantors to disclose an APR for most credit agreements. Instead, they would have been required to disclose the annual interest rate for credit agreements and the dollar amount of any non-interest charges for which a borrower would be liable in connection with the credit agreement. Moreover, there would have been certain non-quantitative restrictions on non-interest charges.

[160] Basically, credit grantors would have been able to impose two sorts of non-interest charge in connection with a consumer credit agreement: (1) charges to cover disbursements such as legal fees, appraisal fees and official fees; and (2) a single "flat charge." A credit grantor who wished to impose flat charges in connection with any of its credit agreements would have been required to divide all of its consumer credit products into categories (based on criteria of the credit grantor's own choosing), and would have been required to impose the same flat charge for all credit agreements within a category.

[161] The object of requiring credit grantors to categorize credit agreements and charge the same flat charge for all credit agreements within a certain category was to facilitate timely disclosure of non-interest charges to prospective borrowers. To this end, early versions of the CCDA included a requirement for credit grantors to disclose (1) how they categorized their credit agreements and (2) the flat charge

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[162] We earlier gave the example of casualty insurance (e.g. fire insurance) that is required by the credit grantor. Although required by the credit grantor as a condition of getting credit, the insurance is of independent value to the borrower.

for each category. They would have been required to disclose the information to anyone who requested it. The premise was that such disclosure, combined with consumer resistance to paying large lump-sum charges, would discourage credit grantors from inflating their flat charges in order to attract consumers with artificially low interest rates. In this regard, one purpose of the proposal to require credit grantors to disclose their flat charges to anyone who requested this information was to facilitate third-party collection and dissemination of comparative information about the cost of credit.[163]

[162] As mentioned earlier, the ALRI-ULCC's proposed approach was rejected in 1995 by the Working Group.[164] The Working Group's consultation paper did not discuss the ALRI-ULCC proposals in detail, simply observing, "After careful reflection, the Committee has not proposed the approach recommended by the ULCC on this issue."[165] Instead, it was proposed to retain the traditional approach to APR disclosure:

> It is proposed that an Annual Percentage Rate declaration should continue to be at the core of disclosure for fixed credit. The APR is regarded as an effective tool for cost comparison on the part of consumers.[166]

ALRI-ULCC remained convinced that their proposed approach had more to recommend it than was conceded by the Working Group. Nevertheless, after 1995 ALRI-ULCC concentrated on assisting the Working Group (and the CMC) in implementing the decision to retain mandatory APR disclosure.

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[163] Third-party collection and dissemination of comparative cost of credit information through a medium such as the Internet would have obvious advantages over mandatory APR disclosure as a means of facilitating credit shopping by consumers and of encouraging price competition amongst credit grantors. Third party collection and dissemination of cost of credit information is discussed in Bowes 1991 at 219-20; ALRI 1995 (5), *passim*; Bowes 1997 at 216-17; Lanyon 241-42. The biggest hurdle to be overcome in designing an effective third-party system would be to find a cost-effective way for the third-party to get the raw data necessary to provide comparative cost of credit information.

[164] Working Group 1995 at 6-7.

[165] Working Group 1995 at 6.

[166] Working Group 1995 at 7. As noted earlier, by 1996 the CMC was proposing to retain APR disclosure for open credit not associated with credit cards.

E. Room for Improvement

[163] In this section of the Report we briefly mention certain aspects of FTA Part 9 where there may be room for incremental improvements. We emphasize that we are essentially talking here about constructive tinkering: useful but modest changes that might be made within the context of the fundamental policies that have been agreed to by all Canadian jurisdictions in the Harmonization Agreement. Thus, although we continue to be of the view that the policy of mandatory APR disclosure by credit grantors is worth revisiting at some point, this is not the forum in which it will be revisited. We also emphasize that, given the time and effort that has gone into the harmonization process, any constructive tinkering with FTA Part 9 should be coordinated with similar efforts in other Canadian jurisdictions.

[164] Any statute dealing comprehensively with cost of credit disclosure will be fairly hefty and complex, especially when it must prescribe rules for calculating the APR. Indeed, although many credit grantors may be dismayed by the sheer size of FTA Part 9 and the CCDR, our legislation is positively skeletal when compared to ccdl in jurisdictions such as the United States and the United Kingdom. Nevertheless, there seems to be scope for reducing the complexity of the disclosure requirements under FTA Part 9.

1. Complexity in defining components of cost of credit

[165] A certain amount of complexity is inherent in any attempt to define the elements of the cost of credit, especially where policy makers have decided to exclude certain charges that in theory should be included in the cost of credit. It could be argued, however, that some of the distinctions drawn by the Harmonization Agreement and FTA Part 9 add complexity and uncertainty for credit grantors without improving the usefulness of cost of credit disclosures to consumers.

[166] An example of what could be regarded as unnecessary complexity is provided by FTA section 59(3)(f)(iv), which was referred to earlier in this report. It provides that "a premium for casualty insurance on the subject matter of a security interest, if the borrower is a beneficiary of the insurance and the insured amount is the full insurable value of the subject-matter" is regarded as value received by the borrower. From a policy perspective, it is difficult to see what

difference it should make whether or not the insured amount bears any particular relationship to the value of the property for the purpose of determining whether the premium is part of the cost of credit. If the borrower is a beneficiary of the insurance, it is of value to the borrower regardless of whether the insured amount is or is not the full insurable value of the insured property.

[167] A couple of other examples of distinctions whose rationale is hard to discern concern legal fees and title insurance. In either case, the cost of the relevant service must be treated as part of the cost of credit if (1) the credit grantor incurs the cost in the first instance and then charges it to the borrower or (2) the lawyer or title insurer is not chosen by the borrower. But the cost of the service is not part of the cost of credit if the borrower chooses the lawyer or insurer and pays for the relevant services directly.[167]

[168] In theory, there are arguments for treating the cost of legal services or title insurance that the borrower is required to pay for in order to get a loan as part of the cost of credit. There are also arguments for excluding such charges from the cost of credit on practical grounds. But it is difficult to see why the inclusion or exclusion of such charges from the cost of credit should depend on whether the borrower chooses the service provider or whether the borrower pays the service provider directly.

2. Complexity in Advertising Disclosure Provisions

[169] Some of the distinctions drawn by the advertising provisions of the FTA and CCDR seem to add complexity without necessarily advancing the cause of disclosure. For example, following the Harmonization Agreement, CCDR section 6(2) provides that any advertisement that advertises credit and states the interest rate or amount of any payment must also disclose the APR and term of the advertised credit agreement. Section 6(3)(b) then goes on to provide that

> an advertisement for a credit sale in connection with which a non-interest finance charge would be payable must disclose
>
> (i) the cash price, and
>
> (ii) the total cost of credit,
>
> except that an advertisement on radio, television or a billboard or other media with similar time or space limitations is not required to disclose the total cost of credit.

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[167] FTA s. 59(5)(b).

[170] The distinctions made in FTA section 6(3)(b) raise several questions. Why should the requirement to disclose the total cost of credit depend on whether there is a non-interest finance charge? If the total cost of credit is important information, it is important whether there are non-interest finance charges are not. Why does the total cost of credit have to be disclosed for a credit sale, but not a loan, with non-interest finance charges? And if the total cost of credit is important enough to disclose at all, would it really be that time or space-consuming to disclose it in a radio or television advertisement or on a billboard?

3. Increasing Flexibility of APR Calculation Mechanics

[171] North American ccdl has always required disclosure of a nominal APR, rather than the effective APR required in the UK and Europe.[168] There is much to be said for the UK and European approach.[169] But we do not propose to say it here. Rather, we take it as a given that Canadian credit grantors will continue to be required to disclose a nominal APR. The point we make here is that the APR calculation mechanics could be adjusted to make them somewhat more forgiving without materially affecting the accuracy or comparability of APR disclosures.

[172] The adjustment we have in mind would provide Canadian credit grantors with the same flexibility that is provided to American credit grantors under the TILA with respect to the mechanics of calculating the APR. Regulation Z, which fills in the details of the TILA, allows credit grantors to calculate the APR using either of two mathematical approaches. One is referred to as the "actuarial method," the other as the "United States Rule" method.

[173] Supplement I to Regulation Z, the official staff interpretation, elaborates the similarities and difference between the actuarial method and U.S. rule method:

> 1. *Calculation method.* . . . Both methods [actuarial and U.S. rule] yield the same annual percentage rate when payment intervals are equal. They differ in their treatment of unpaid accrued interest.

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[168] An APR calculated "yearly not in advance," as contemplated by CCDR section 23 would be a true effective annual rate. An APR calculated "half-yearly not in advance," the other alternative under CCDR section 23, would lie somewhere between an effective rate and a nominal rate. As noted previously, section 23 is designed to allow for consistency between the APR and an interest rate disclosed in accordance with section 6 of the *Interest Act* (Canada).

[169] See e.g. Celec 1991.

> 2. *Actuarial method*. When no payment is made, or when the payment is insufficient to pay the accumulated finance charge, the actuarial method requires that the unpaid finance charge be added to the amount financed and thereby capitalized. Interest is computed on interest since in succeeding periods the interest rate is applied to the unpaid balance including the unpaid finance charge. . .
>
> 3. *U.S. Rule*. The U.S. Rule produces no compounding of interest in that any unpaid accrued interest is accumulated separately and is not added to principal. In addition, under the U.S. Rule, no interest calculation is made until a payment is received.

[174] For a standard instalment loan, the actuarial method and the United States Rule method are effectively identical. If however, there are irregularities in the timing of payments required under a credit agreement, the actuarial method and U.S. Rule method may produce slightly different APRs. For example, if a consumer is not required to make any payments for the first six months of a 24-month loan, and makes monthly payments for the remaining 18 months of the term, the APR will be slightly higher when calculated using the U.S. Rule method than when using the actuarial method. American policy-makers have decided that the differences are so slight that it will do no harm to allow credit grantors to use either method.

[175] Although the FTA does not use the term, the method of calculating the APR that it prescribes is what the Americans refer to as the United States Rule method. As noted above, there is no difference between the actuarial method (as defined by Regulation Z) and the U.S. Rule method for regular payment loans in which there are no skipped payments. However, if there are irregularities in the payment schedule (such as a payment holiday at the beginning of the term) an APR calculated using the actuarial method may be lower than an APR calculated using the U.S. Rule method by more than the 1/8 of 1% tolerance allowed by the CCDR.[170] The problem is that a credit grantor who uses standard calculator or spreadsheet functions to calculate the APR for a loan will be using the actuarial method to do the calculation. We think consideration should be given to removing this trap for the unwary by giving credit grantors the option of calculating APRs using the actuarial method, as an alternative to the U.S. Rule method.

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[170] CCDR s. 27(5).

4. Rent-to-own

[176] We noted earlier that although the provision that determines the types of leases to which FTA Part 9 applies does not use the term "rent-to-own," it is worded in a way that captures this type of transaction.[171] From a policy perspective, we think the imposition of disclosure requirements for rent-to-own contracts is well justified. Legally, a rent-to-own ("RTO") contract is distinguishable from a long-term lease or a credit sale because the consumer under an RTO contract does not incur long-term commitments. On the other hand, RTO marketing often portrays it as an alternative means of financing the purchase of goods. If RTO is portrayed as an alternative mode of financing the purchase of goods, there is much to be said for providing consumers with information that will allow them to compare the cost of this mode of financing with the cost of other modes of financing.

[177] It must be said, however, that the lease disclosure requirements of the CCDR are not as sensitive to the idiosyncrasies of RTO transactions as they might be. For example, CCDR section 26(4) provides that for the purposes of calculating the implicit finance charge and APR, the term of a lease for an indefinite term is assumed to be one year.[172] It may well be, however, that the terms of a particular RTO contract will provide a more appropriate assumption for calculating these values. The contract might provide, for instance, that if the consumer rents the goods for 18 months they will automatically become their owner. In such a case, it is arguably more logical to base the APR and implicit finance charge calculations on an 18 month term than on a 12 month term.

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[171] FTA s. 91. One of the characteristics of a typical rent-to-own contract is that it is for an indefinite term, or the term is renewed automatically unless one of the parties takes steps to terminate it. This characteristic brings it within section 91.

[172] CCDR s. 27(3) provides a similar assumption for demand loans.

F. Conclusion

[178] There is an inherent tension in cost of credit disclosure legislation. The legislative objective is to assist consumers in getting the information they need at the time they need it to make informed choices about whether to get credit and where to get it. However, it is not simply a case of the more disclosure the merrier. Increasing the disclosure burden on credit grantors increases their costs, and credit grantors will naturally attempt to pass these costs on to consumers. There will come a point when the increased cost to credit grantors of increased or more complex disclosure requirements will exceed the incremental benefit to consumers of such disclosure.

[179] We think the harmonization process has resulted in improvements to ccdl in Alberta and throughout Canada. Nevertheless, there is scope for continued improvement. The foregoing suggestions are not meant to be exhaustive of areas of FTA Part 9 where there is scope for improvement through fine tuning. We would be surprised if experience with FTA Part 9 and the corresponding legislation in other Canadian jurisdictions over the next few years does not reveal additional opportunities for incremental improvement. Thus, we hope the Alberta government, in coordination with other Canadian governments, keeps this area under continuing review. And at some time in the not too distant future, it would be worthwhile for governments to undertake a fundamental reassessment of the traditional approach to cost of credit disclosure in light of the opportunities provided by developments in the field of information technology.

B.R. BURROWS
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A.D. FIELDING
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W.H. HURLBURT
H.J.L. IRWIN
P.J.M. LOWN
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